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Supreme Court of the United States

OCTOBER THEM, 1964

No. 134

0

PARAGON JEWEL COAL COMPANY, INC.,

COMMISSIONER OF INTERNAL REVENUE.

No. 237

COMMISSIONER OF INTERNAL REVENUE,

10.8

ROBERT LEE MERRETT, ET UX., ET AL.

ON WRITS OF CRETIONARI TO THE UNITED STATES COURT OF APPRAIS FOR THE POURTH CIRCUIT

NO. 184 PETITION FOR CERTIONARI FILED JUNE 1, 1964
NO. 237 PETITION FOR CERTIONARI FILED JULY 1, 1964
NO. 184 CERTIONARI CRANTED OCTOBER 12, 1964
NO. 237 CERTIONARI GRANTED OCTOBER 26, 1964

SUPREME COURT OF THE UNITED STATES OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 237

COMMISSIONER OF INTERNAL REVENUE; PETITIONER,

US.

ROBERT LEE MERRITT, ET UX., ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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[fol. A] [File endorsement omitted]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket No. 84122

ROBERT LEE MERRITT and WINNIE MERRITT, Petitioners,

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition—Filed November 23, 1959

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, (Symbols Ap:RI:ABD:MTM) dated August 26, 1959, and as a basis of their proceeding allege as follows:

- 1. The petitioners are husband and wife who reside in Grundy, Virginia. The returns for the years involved were filed with the District Director of Internal Revenue, Richmond, Virginia.
- 2. The notice of deficiency, a copy of which is attached hereto and made a part of this petition by reference, is dated August 26, 1959.
- [fol. B] 3. The taxes in controversy are income taxes for the years 1954, 1955 and 1956, the detail of which is as follows:

Year *	•	Deficiency	Sec. 294(d) Penalty
1954		\$ 848.48	\$343.74
1955		1,532.21	-0-
1956		3,373.52	-0-
/	TOTAL	\$ 05.754.01	4949.74
1.	TOTAL -	\$5,754,21	\$343.74

4. The determination of tax in said notice of deficiency is based upon the following errors:

B. Respondent erred in increasing petitioners' distributive share of partnership income from the Standard Smokeless Coal Company for the year 1955 by the amount of \$5,111.59, on account of "depletion disallowed."

C. Respondent erred in increasing petitioners' distributive share of partnership income from the Standard Smoke-[fol. C] less Coal Company for the year 1956 by the amount of \$6,918.36 on account of "depletion disallowed."

1. Respondent erred in determining that petitioners were liable for the addition to tax under Section 294(d) (1)(A) of the Internal Revenue Code of 1939 in the amount of \$208.50 for the year 1954 for failure to file a declaration of estimated tax.

E. Respondent erred in determining that petitioners were liable for the additions to tax under Section 294(d)(2) of the Internal Revenue Code of 1939 in the amount of \$135.24 for the year 1954 for substantial underestimate of estimated tax.

5. The facts upon which the petitioners rely are as follows:

A. Petitioners are United States citizens who are married and live in Grundy, Virginia. They filed joint Federal Income Tax returns for the years 1954, 1955 and 1956 with the District Director of Internal Revenue, Richmond, Virginia.

B. Petitioner, Robert Lee Merritt, is a general partner in Standard Smokeless Coal Company, a partnership which [fol. D] is engaged in the business of mining and producing coal. In 1954 and 1955 the other partners in this enterprise were G. Wesley Merritt of Louisa, Kentucky, and J. O. Watson of Louisa, Kentucky. Each partner had an approximately equal interest in the partnership in 1955 and each devoted most of his time to the business of the partner-

ship. In the year 1956 petitioner's partners in this enterprise were G. Wesley Merritt of Louisa, Kentucky, and Jack D. Merritt of Grundy, Virginia. In the year 1956 petitioner had approximately a 50% interest in the partnership while G. Wesley Merritt and Jack D. Merritt each had approximately a 25% interest in the partnership. In this year all partners devoted substantial time to the business of the partnership. J. O. Watson had a small interest in the partnership in the year 1956, and he devoted part of his time to the partnership business.

- C. The Standard Smokeless Coal Company mined and produced coal during the years 1954, 1955 and 1956 under an oral agreement with the Paragon Jewel Coal Company, Inc., of Whitewood, Virginia. Under this agreement petitioner and his partners held the right to mine all coal [fol. E] within certain designated boundaries; they were required to, and did, make the investment necessary to mine and produce the coal; the partners had a capital interest in the coal in place, and the possibility of a return on their investment depended solely upon the extraction and sale of the coal which they produced.
- D. During the years 1954, 1955 and 1956, petitioner and his partners held an economic interest in the coal which they produced under their agreements with Paragon Jewel Coal Company, Inc., and are entitled to percentage depletion under the Internal Revenue Codes of 1939 and 1954.
- E. During the year 1954 Standard Smokeless Coal Company received gross income from coal produced under its contract with Paragon Jewel Coal Company, Inc., in the amount of \$103,850.66. The net income from the production of this coal, before the allowance of depletion, was \$30,636.64. Depletion was claimed in the partnership return in the amount of \$10,385.07.
- F. Respondent disallowed the depletion claimed in the partnership return for the year 1954 and increased petitioners' distributive share of partnership income by the [fol. F] amount of \$3,455.27 which represents one-third of the depletion claimed by the partnership.

H. Respondent disallowed the depletion claimed in the partnership return for the year 1955 and in respect of the disallowance increased petitioners' distributive share of partnership income by the amount of \$5,111.59 which represents one-fourth of the depletion claimed by the partnership.

I. During the year 1956 Standard Smokeless Coal Company received gross income from coal produced under its contract with Paragon Jewel Coal Company, Inc., in the amount of \$138,367.56. The net income from the production of this coal, before the allowance of depletion, was \$38,456.86. Depletion was claimed in the partnership return [fol. G] in the amount of \$13,836.76.

J. Respondent disallowed the depletion claimed in the partnership return for the year 1956 and increased petitioners' distributive share of partnership income by the amount of \$3,459.18 which represents one-fourth of the depletion claimed by the partnership.

K. Petitioners' failure to file a declaration of estimated tax was due to reasonable cause and not to willful neglect. Petitioners did not file an estimate of tax for the year 1954 and are not liable for substantially underestimating their tax.

L. In his notice of deficiency respondent determined that petitioners were liable for failure to file a declaration of testimated tax under §294(d)(1)(A) of the Internal Revenue Code of 1939 and for substantially underestimating their tax under §294(d)(2) of the Internal Revenue Code of 1939.

Wherefore, Petitioners pray this Court may hear the proceeding and:

1. Determine that the respondent erred in the matters set forth in sub-paragraphs A to E, inclusive, of paragraph 4 of this petition.

[fol. H] 2. Grant such other and further relief as this Court may deem proper.

John Y. Merrell, K. William O'Connor, 850 Shoreham Building, Washington 5, D. C., Attorneys for Petitioners.

Duly sworn to by Robert Lee Merritt and Winnie Merritt, jurat omitted in printing.

[fol. I]

ATTACHMENT TO PETITION

Av 26 1959

REGISTERED MAIL

Ap:RI:ABD:MTM

Mr. Robert Lee Merritt and Mrs. Winnie Merritt, Husband and Wife Grundy, Virginia

Dear Mr. and Mrs. Merritt:

The determination of your income and liability for the taxable years ended December 31, 195 December 31, 1955, and December 31, 1956 disclosed deficiencies in tax aggregating \$5,754.21 and penalty of \$343.74, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies and penalty mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiencies and penalty. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays, and legal holidays are to be counted in computing the 90 day period.

Should you not desire to file a petition, you are requested to execute the enclosed form 870 and forward it to this office. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiencies and penalty, and will prevent the accumulation of interest, since the interest period termi[fol. J] nates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earliest.

Very truly yours, Dana Latham Commissioner

By (Signed) H. O. BUTLER
H. O. Butler
Associate Chief, Appellate Division

Enclosures:
Statement
IRS Pub. No. 160
Agreement Form 870

[fol. K]

Statement

Mr. Robert Lee Merritt and Mrs. Winnie Merritt, Husband and Wife Grundy, Virginia

Tax Liability for the Taxable Years Ended
December 31, 1954
December 31, 1955
December 31, 1956

Income Tax

Year	Deficiency	Sec. 294(d) Penalty
1954	* \$ 848.48	\$343.74
1955	1,532.21	a _0_
1956	3,373.52	-0-
Makala	 A5:754.01	4040.74
Totals	\$5,754.21	\$343.74

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 19, 1957; to your protest dated May 16, 1958; and to statements made at the conferences held at Richmond, Virginia on October 23, 1958 and May 14, 1959.

A copy of this letter and statement has been mailed to your duly authorized representative, Mr. Jack Persinger, Richlands, Virginia.

Taxable Year Ended December 31, 1954.

Adjustment to Taxable Income

Taxable income disclosed by return \$ 6,752,62

Additional income and unallowable deductions:

(a) Partnership income increased

3,455.27

Taxable income adjusted

\$10,207.89

Explanation of Adjustment

[fol. L] (a) Examination of the books and records of Standard Smokeless Coal Company (partnership) discloses that your share of the distributable income for the year 1954 is \$8,657.89. Inasmuch as you reported \$5,202.62, your taxable income has been increased by the difference of \$3,455.27, computed as follows:

Ordinary net income per partnership return	\$20,538.61
Add: Unallowable deductions:	
(1) Depletion disallowed	10,385.07
	3
Corrected partnership ordinary net income	\$30,923.68
Your distributive share	8,657:89
Partnership income reported	5,202.62
Understatement of partnership income	\$ 3,455.27

Explanation of partnership adjustment:

(1) It has been determined that the partnership is not entitled to percentage depletion deduction claimed in the amount of \$10,385.07.

Computation of Tax

Taxable income adjusted	\$10,207.89
Income tax (joint basis)	2,254.06
Add: Self-employment tax, per retu	rn 108.00
Total correct income tax liability Tax disclosed by return: Original,	2,362.06
No. BF-1005458	1,513.58
Deficiency	*848.48
Sec. 294(d) penalty (Exhibit A)	343.74
Taxable Year Ended Dece	mber 31, 1955
. Adjustment to Taxable	e Income
Taxable income disclosed by return	\$ 9,193.63
Additional income and unallowable of	deductions:
(a) Partnership income increased	5,481.52
Taxable income adjusted	\$14,675.15
Taxable income adjusted [fol. M] Explanation of Adju-	
	nstment I records of Standard hip) discloses that your for the year 1955 is ed \$12,499.90, your tax-
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4	records of Standard nip) discloses that your for the year 1955 is ed \$12,499.90, your tax- 81.52, computed as fol-
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows:	records of Standard hip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as fol-
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows: Ordinary net income per partnersh Add: Additional income and unallo deductions:	records of Standard aip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as followable
[fol. M] Explanation of Adjutation (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reported able income has been increased \$5,4 lows: Ordinary net income per partnershi Add: Additional income and unallows.	records of Standard aip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as followable \$20,699.69
[fol. M] Explanation of Adjutant (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows: Ordinary net income per partnershi Add: Additional income and unallo deductions: (1) Mining income increased (2) Depletion disallowed	records of Standard hip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as followable 1,109.80 15,334.78
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows: Ordinary net income per partnershi Add: Additional income and unallo deductions: (1) Mining income increased (2) Depletion disallowed Corrected partnership ordinary net	records of Standard hip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as followable 1,109.80 15,334.78 income \$37,144.27
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows: Ordinary net income per partnershi Add: Additional income and unallo deductions: (1) Mining income increased (2) Depletion disallowed Corrected partnership ordinary net Your distributive share	1,109.80 15,334.78 17,981.427 17,981.42
[fol. M] Explanation of Adju (a) Examination of the books and Smokeless Coal Company (partnersh share of the distributable income \$17,981.42. Inasmuch as you reporte able income has been increased \$5,4 lows: Ordinary net income per partnershi Add: Additional income and unallo deductions: (1) Mining income increased (2) Depletion disallowed Corrected partnership ordinary net	records of Standard hip) discloses that your for the year 1955 is ed \$12,499.90, your tax-81.52, computed as followable 1,109.80 15,334.78

Explanation of partnership adjustments:

(1) It has been determined that income from mining was understated to the extent of \$1,109.80.

(2) It has been determined that the partnership is not entitled to percentage depletion deduction claimed in the amount of \$15,334.78.

Computation of Tax.	
Taxable income adjusted	\$14,675.15
Income tax (joint basis)	3,522.55
Add: Self-employment tax, per return	126.00
Total correct income tax liability Tax disclosed by return: Original, Account No. BF-1005441	\$ 3,648.55 2,116.34
Deficiency	\$ 1,532.21
F. 0. 1. 373	

[fol. N]

Taxable Year Ended December 31, 1956

Adjustment to Taxable Income

Taxable income disclosed by return \$10,529.42

Additional income and unallowable deductions:

(a) Partnership income increased 10,605.24

Taxable income adjusted \$21,134.66

Explanation of Adjustment

(a) Examination of the books and records of Standard Smokeless Coal Company (partnership) discloses that your share of the distributable income for the year 1956 is \$24,899.50. Inasmuch as you reported \$14,294.26, your taxable income has been increased \$10,605.24, computed as follows:

Ordinary net income per partnership return \$26,774.54 Add: Additional income and unallowable deductions:

3	(1)	Mining inc me increased	-	i,	7,373.70
	(2)	Depletionallowed			13,836.76

Corrected partnership ordinary net income Your distributive share Partnership income reported	\$47,985.00 24,899.50 14,294.26
Understatement	\$10,605.24
Explanation of partnership adjustments:	
(1) It has been determined that the income f was understated to the extent of \$7,373.70.	rom mining
(2) It has been determined that the partner entitled to percentage depletion deduction class amount of \$13,836.76.	
[fol. O] Computation of Tax	-/-
Taxable income adjusted Income tax (joint basis) Add: Self-employment tax, per return	\$21,134.66 5,711.17 126.00
Total correct income tax liability Tax disclosed by return: Original, Account No. BF-1006349	\$ 5,837.17 2,463.65
Deficiency Exhibit A	\$ 3,373.52
Computation of Additions to Tax une Section 294(d) of the I.R.C. (1939)	
Sec. 294(d)(2):	
Corrected tax 6% of above	\$2,254.06 \$ 135.24
Sec. 294(d)(1)(A):	
Corrected tax	\$2,254.06
Less: Withholding tax actually withheld \$ -0- Overpayment credit, if any, from a prior year -0-	-0-
Balance to be divided into 4 installments due	\$2,254.06.

		-
1 40		91
[fo	A. J	P]

· · · · · · · · · · · · · · · · · · ·		./		1% for Each Ad-	
Amount Due	Installment Due Date	Date Paid	Addition for First Montl Unpaid	or ditional	Not More Than 10% Assessable
563.51 563.52 563.52 563.52	3-15-54 6-15-54 9-15-54 1-15-55	Unpaid Unpaid Unpaid Unpaid	5% 5% 5%	5% 5% 5% 2%	\$ 56.35 56.35 56.35 39.45
\$2,254.06	1-10-00	A	ddition t	o Tax	\$208.50 \$343.74

[fol. Q] [File endorsement omitted]

Before Tax Court of the United States

Docket No. 84122

[Title omitted]

REQUEST FOR DESIGNATION OF PLACE OF HEARING—Filed November 23, 1959

Come now the petitioners, by their attorneys, John Y. Merrell and K. William O'Connor, and in accordance with Rule 26 of the Rules of Practice Before the Tax Court of the United States,

Request that the Court designate that the hearing in the above-entitled proceeding be held at Washington, D.C.

John Y. Merrell, K. William O'Connor, 850 Shoreham Building, Washington 5, D.C.

[Stamp—Tax Court of the U. S.—Granted—Nov 24 1959— J. S. Murdock]

[fol. R] [File endorsement omitted]

Before the Tax Court of the United States Docket No. 84122

[Title omitted]

Answer-Filed January 21, 1960

The Respondent, in answer to the petition filed in the above-entitled case, admits and denies as follows:

- 1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.
- 4. A to E, inclusive. Denies that respondent erred as alleged in subparagraphs A to E, inclusive, of paragraph 4 of the petition.
- 5. A. Admits the allegations of fact contained in subparagraph A of paragraph 5 of the petition.
- 5. B. Admits that the petitioner, Robert Lee Merritt, is a general partner in Standard Smokeless Coal Company, a partnership which is engaged in the business of mining and producing coal and that in 1954 and 1955 the other partners in this enterprise were G. Wesley Merritt of Louisa, Kentucky, and J. O. Watson of Louisa, Kentucky. Denies the remaining allegations of fact contained in subparagraph B of paragraph 5 of the petition.
- 5. C. Admits that the Standard Smokeless Coal Company mined and produced coal during the years 1954, 1955, and 1956 under an oral agreement with the Paragon Jewel Coal Company, Inc., of Whitewood, Virginia. Denies the remaining allegations of fact contained in subparagraph C of paragraph 5 of the petition.
- 5. D. Denies the allegations of fact contained in subparagraph D of paragraph 5 of the petition.
- [fol. S] 5. E. Admits that depletion was claimed in the partnership return in the amount of \$10,385.07. Denies the remaining allegations of fact contained in subparagraph E of paragraph 5 of the petition.

- 5. F. Admits the allegations of fact contained in subparagraph F of paragraph 5 of the petition.
- 5. G. Admits that depletion was claimed in the partnership return in the amount of \$15,334.78. Denies the remaining allegations of fact contained in subparagraph G of paragraph 5 of the petition.
- 5. H. Admits the allegations of fact contained in subparagraph H of paragraph 5 of the petition, except it is denied that the amount of \$5.111.59 represents one-fourth of the depletion claimed by the partnership.
- 5. I. Admits that depletion was claimed in the partner-ship return in the amount of \$13,836.76. Denies the remaining allegations of fact contained in subparagraph I of paragraph 5 of the petition.
- 5. J. Admits the allegations of fact contained in subparagraph J of paragraph 5 of the petition.
- 5. K. Admits that petitioners did not file an estimate of tax for the year 1954. Denies the remaining allegations of fact contained in subparagraph K of paragraph 5 of the petition.
- 5. L. Admits the allegations of fact contained in subparagraph L of paragraph 5 of the petition.
- 6. Denies generally each and every allegation contained in the petition not hereinabove specifically admitted, qualified, or denied.
- [fol. T] Wherefore, it is prayed that the deficiencies determined by the respondent be in all respects approved.
- Hart H. Spiegel, Chief Counsel, Internal Revenue Service.

Of Counsel: Clarence E. Price, Regional Counsel, Ferd J. Lotz, Attorney, Internal Revenue Service, 603 Parcel Post Building, Richmond 19, Virginia.

[fol. U]

CLERK'S NOTE

Petitions and Answers thereto in Docket Nos. 84123, 84124, 84125 and 84126 (G. Wesley Merritt and Fannie J. Merritt, Jack D. Merritt and Willa Gray Merritt, Virgil Bowling and Gladys Bowling and James O. Watson, 3rd and Lucy J. Watson, respectively, v. C. I. R.) are substantially similar to the Petition and Answer in Docket No. 84122 and have been omitted in printing.

[fol. V] [File endorsement omitted]

Before the Tax Court of the United States
Docket No. 90766

PARAGON JEWEL COAL COMPANY, INCORPORATED, Petitioner,

V.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

AMENDED PETITION—Filed February 16, 1961

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (correspondence symbols—Ap; Hu: RMK), dated November 2, 1960, and as a basis of its proceedings, alleges as follows:

- 1. The petitioner is a corporation organized under the laws of the State of Virginia with its principal office located at Bluefield, West Virginia. The returns for the periods here involved were filed with the District Director of Internal Revenue, Parkersburg, West Virginia.
 - 2. The notice of deficiency, a copy of which is attached hereto and made a part of this petition by reference, is [fol. W] dated November 2, 1960.

3. The taxes in controversy are income taxes for the taxable years ending September 30, 1955, September 30, 1956 and September 30, 1957, the detail of which is as follows:

Taxable Year		Deficiency
September 30, 1955		\$ 2,529.29
September 30, 1956		36,588.04
September 30, 1957		57,021.20
•	Total:	\$96.138.53

- 4. All of the deficiency for the taxable year 1955 is in dispute and there is an over-assessment for said year of approximately \$6,307.24. The amount of approximately \$35,887.68 is in dispute for the taxable year 1956. The amount of approximately \$56,187.52 is in dispute for the taxable year 1957.
- 5. The determination of tax set forth in said notice of deficiency is based upon the following errors:
- A) Respondent erred in disallowing the deduction in the amount of \$33,986.65 as "over-riding" royalties paid to C. A. Clyborne for the taxable year 1955.
- B) Respondent erred in increasing petitioner's percentage depletion by the amount of \$17,883.55 for the taxable year 1955. This percentage depletion should have been increased by only \$890.22 for said taxable year 1955.
- C) Respondent erred in disallowing the deduction in the [fol. X] amount of \$43,204.21 as "over-riding" royalties paid to C. A. Clyborne for the taxable year 1956.
- D) Respondent erred in decreasing the percentage depletion in the amount of \$24,158.32 for the taxable year 1956. The petitioner is entitled to an additional depletion allowance of \$1,652.25 for said year.
- E) Respondent erred in disallowing the deduction in the amount of \$46,665.22 as "over-riding" royalties paid to C. A. Clyborne for the taxable year 1957.

- F) Respondent erred in decreasing the percentage depletion in the amount of \$59,895.08 for the taxable year 1957. Petitioner is entitled to an additional depletion allowance of \$1,492.62 for said year of 1957.
- 6. The facts upon which the petitioner relies are as follows:

I

- A) Petitioner is a corporation organized under the laws of the State of Virginia, with its business office located in Bluefield, West Virginia. The income tax returns for the fiscal years ended September 30, 1955, September 30, 1956 and September 30, 1957 were filed with the District Director of Internal Revenue at Parkersburg, West Virginia. This corporation has coal properties located in [fol. Y] Buchanam County, Virginia, where it is the lessee of some 4,932 acres of bituminous coal land under eight separate leases.
- B) The president and principal stockholder of this corporation, which was chartered on the 22nd day of October, 1951, is C. A. Clyborne of Bluefield, West Virginia. Mr. Clyborne has been the president of this corporation since its formation.
- C) Mr. C. A. Clyborne has been engaged in the business of a coal broker and as a mine operator for many years prior to the formation of this corporation and his reputation and financial position was well-known throughout the area of southwest Virginia and West Virginia. As a result of his ability, experience, reputation and financial standing, he was able to procure coal leases in Buchanan County, Virginia by personal contacts and negotiations with the owners of the coal lands. These coal leases were secured beginning in the year 1946.
 - D) Prior to the formation of the taxpayer corporation, C. A. Clyborne acquired, in the year 1946, a certain coal lease known as the "Clyde Dennis Lease" from land owners in Buchanan County, Virginia; this lease being made between the land owners and C. A. Clyborne and J. H. Franks.

This lease required the payment of minimum royalties to the land owners, payment of taxes and a guarantee that the coal would be properly mined with maximum recovery. Failure to recover all of the merchantable coal imputes a liability to pay for said coal, even though not mined. Mr. [fol. Z] Clyborne was also required to pay a royalty of ten cents (10¢) per ton for each ton of coal mined from said lease. All of the obligations under this lease were personal obligations of C. A. Clyborne.

- E) On October 22, 1951 the Paragon Jewel Coal Company, Incorporated was duly organized under the laws of the State of Virginia and thereafter Mr. Clyborne and Mr. Franks subleased the "Clyde Dennis" property to said Corporation for a royalty of 30¢ per ton for all coal mined. The Corporation thereafter paying this royalty to Clyborne who thereupon paid the landowners of the "Dennis property" the sum of 10¢ per ton as required by the original lease and C. A. Clyborne retained 15¢ per ton, as an "everriding" royalty and paid to J. H. Franks, who had assisted Clyborne in securing this lease, the sum of 5¢ per ton as an "over-riding" royalty. The respondent has recognized the right of C. A. Clyborne to an "over-riding" royalty. but has reduced the amount of the "over-riding" royalty allowed to Clyborne from 15¢ per ton to 5¢ per ton, thus permitting the Corporation to charge the sum of only 20¢ per ton royalty as ordinary and necessary expenses of the Corporation.
- F) Following the organization of said Corporation as aforesaid, it constructed a cleaning and processing plant and began the mining of coal from the leased coal lands. [fol. AA] C. A. Clyborne continued to secure additional coal leases from landowners in Buchanan County, Virginia, which were subsequently subleased to the Corporation under arrangements similar to those referred to in Paragraph E). The Corporation paid to Clyborne the full amount of the royalty and Clyborne remitted to the landowners the royalties due them and retained an "over-riding" royalty for himself. This sublease procedure was necessary because the landowners in Buchanan County, Virginia had personal knowledge of Mr. Clyborne's reputation, financial

condition and experience in the coal business. The landowners would not lease direct to the Corporation, and Clyborne was, therefore, required to secure these additional leases in his own name. As a result thereof C. A. Clyborne remained personally liable for all the terms and conditions of said leases and was personally responsible for the performance of same. The sublease from Clyborne to the Corporation did not release him from his own personal liability and responsibility to the landowners under the terms of the original leases. The respondent has disallowed that portion of the royalty paid by the Corporation to Clyborne which was in excess of the royalties paid by Clyborne to the landowners.

- G) The total royalty paid by Paragon Jewel Coal Company, Incorporated for the coal, including the "over-riding" royalties retained by Mr. Clyborne, were in line with the [fol. BB] per ton royalties paid by other companies for coal lands of the same kind and quality in the area.
- H) The "over-riding" royalties which C. A. Clyborne received from the coal mined from the five leases referred to in Paragraph F) were ordinary and necessary expenses of the Corporation, properly deductible as such and did not amount to a distribution of corporate profits to C. A. Clyborne,

П

I) The petitioner, Paragon Jewel Coal Company, Incorporated, has a coal cleaning and processing plant located on its coal lands in Buchanan County, Virginia. The Corporation has an investment in this cleaning and processing plant of approximately seven hundred thousand dollars (\$700,000.00). In addition to the cleaning and processing plant the Corporation has constructed all necessary roads, bridges, electric power lines, and other facilities for the removal of the petitioner's coal from the land to petitioner's processing plant. In order to remove the coal from petitioner's leases, petitioner employs independent contractors to extract coal under a system known in the coal industry as the "drift mining" method. Petitioner builds the

roads to the mines and "faces" the mine for the independent contractor who then proceeds to remove petitioner's coal and deliver it by means of truck to the petitioner's process-[fol. CC] ing plant. All coal mined by these contractors is brought to the processing plant owned and operated by the Paragon Jewel Coal Company, Incorporated where it is cleaned, weighed and graded. The contractors are paid an extraction fee for each ton of coal delivered to petitioner's processing plant. The cleaning and processing of the coal is an indispensable prerequisite to marketing the product and said coal in the condition in which it is delivered to petitioner is not commercially saleable.

- J) When operations under the above arrangement first began and for some period thereafter, the work was performed under oral contracts. However, subsequently the oral agreements between the contractors and the petitioner corporation were formalized by written contracts which were signed by twelve of the fifteen contractors, covering thirty separate mine operations then mining the Paragon Jewel Coal Company coal. Only three contractors have continued to operate under the oral agreement heretofore existing between said contractors and petitioner. The terms of the oral agreements, however, were the same as in the written contracts which simply reduced to writing the understanding as it had existed before.
- K) Under the terms of the oral contracts Paragon Jewel Coal Company faced the seam of goal for entry by the contractor. The contractor supplied his own equipment for mining the coal. Paragon Jewel directed the contractor [fol. DD] where he was to mine, but said contractor was not given any particular designated boundary of coal to mine, nor did he have the right to mine any particular area of coal to exhaustion. All coal extracted by the contractors had to be delivered to the petitioner's processing plant. The contractor is compensated by being paid a fixed sum for every ton of coal delivered to the petitioner at its processing plant. This price is not subject to change retroactively and any price change, if it does occur, can only take place prospectively, after due notice, so that at all

times the contractor knows the price he will receive for every ton of coal which he mines. Thus, it is the petitioner and not the contractor who bears the risk of the market. The contract is terminable at the will of either party. The contractors' equipment is readily moveable from place to place. The petitioner is entitled to the entire percentage depletion allowance on the price received by the petitioner, upon the sale of said coal, without deduction therefrom the amounts paid by the petitioner to the contractor for extracting petitioner's coal.

- L) The government has allowed percentage depletion to the petitioner on the entire price received upon the sale of the coal as to all contractors who have executed written contracts, but has disallowed said percentage depletion to the petitioner on those sums paid to the contractors who [fol. EE] continue to operate under the oral agreement.
- M) During the taxable years 1955, 1956 and 1957 the petitioner corporation had the economic interest in the coal in place and is entitled to all of the percentage depletion during said years.
- N) The respondent, in denying a portion of the percentage depletion to petitioner herein, has, of necessity, rested its claim on that portion of Section 23 (m) of the 1939 Code, now Section 611 (b)(1) of the 1954 Code, which provides: "In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and the lessee." So far as coal is concerned, however, this situation with respect to percentage depletion has been altered by the effect of Section 325 (b) of the Revenue Act of 1951, as an amendment to Section 117 (k)(2) of the 1939 Code. Section 117 (k)(2) of the 1939 Code, as amended in 1951, was divided in 1954 into two sub-sections-Section 631(b), dealing with timber, and Section 631(c), relating to coal. Accordingly, when Section 23 (m) of the 1939 Code, now Section 611 (b)(1) of the 1954 Code, and Section 117 (k)(2) of the 1939 Code, now Section 631 (c) of the 1954 Code, are read together, there is no longer any depletion deduction to be "equitably apportioned between the lessor and the lessee" for the reason that the lessor is

no longer entitled to percentage depletion. The lessor re[fol. FF] ceives capital gains or losses treatment in respect
of his royalties. Therefore, there is nothing now to be apportioned and all percentage depletion belongs indivisibly
to the lessee (petitioner herein) and petitioner is no longer
obligated to share his allowance with any one. The contractors (who, it is assumed, uld be allowed the percentage depletion if denied to the etitioner) are not lessors,
nor are they lessees. Congress well knew the difference
between a lessee of wasting-asset property and a contractor whose activities resulted in depleting that property.

Wherefore, Petitioner prays that this Court may hear the proceeding and:

- 1. Determine that the respondent erred in the matters set forth in sub-paragraphs A to F, inclusive, of Paragraph 5 of this petition and,
- 2. Grant such other and further relief as this Court may deem proper.

LeRoy Katz, Counsel for Petitioner, Ritz Building, P. O. Box 1534, Bluefield, West Virginia.

Katz, Katz and Kantor, Attorneys at Law, Ritz Building, P. O. Box 1534, Bluefield, West Virginia.

[fol. GG] Duly sworn to by C. A. Clyborne, jurat omitted in printing.

fol. HH

ATTACHMENT TO PETITION

Form L-21A (1-60)

(Emblem)

U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
OFFICE OF REGIONAL COMMISSIONER
APPELLATE DIVISION
P. O. Box 1816
HUNTINGTON 17, WEST VIRGINIA

Nov. 2, 1960

Ph. JA 5-8104

IN REPLY REFER TO Ap; Hu:RMK

Gentlemen:

In accordance with the provisions of existing internal revenue laws, notice is given that the determination of your income tax liability for the above-noted taxable year(s) discloses a deficiency (or deficiencies) in the amount(s) shown above. The attached statement shows the computation of the deficiency or deficiencies.

If You Agree to this determination, please sign the enclosed agreement, Form 870, and return it promptly to this office. An addressed envelope is enclosed for this purpose. The signing and filing of this agreement will permit an early assessment of the deficiency or deficiencies and will limit the accumulation of interest.

IF You Do Not Agree, and do not sign and return the enclosed form, the deficiency or deficiencies will be assessed for collection, as required by law, upon the expiration of ninety days from ... date of this letter, unless within that time you contest this determination in the Tax Court of the United States by filing a petition with that Court in accordance with its rules, a copy of which may be obtained by writing to its Clerk, Box 70, Washington 4, D. C.

Very truly yours,

Dana Latham Commissioner

By Wilbur E. Myers
Wilbur E. Myers
Associate Chief, Appellate Division

Enclosures:

Statement Agreement, Form 870 Addressed envelope

[fol. II] Ap:Hu:RMK:JEA .

STATEMENT

Paragon Jewel Coal Company, Incorporated P. O. Box 730
Bluefield, West Virginia
(Formerly: P. O. Box 849
Bluefield, West Virginia.

Tax liabilities for the taxable years ended September 30, 1955 September 30, 1956 September 30, 1957

Income Tax

Fiscal	Year	Liability	Assessed.	Deficiency
September	30, 1955	\$ 98,563.61	\$ 96,034.32	\$ 2,529.29
September	30, 1956	179,949.51	/143,361.47	36,588.04
September	30, 1957	262,605.43	205,584.23	57.021.20
Total		\$541,118.55	\$414 ,980.02	\$ 96,138.53

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated April 3, 1959; to your protest dated June 26, 1959; to the statements made at the conferences held on

March 20, 1959, March 25, 1959, November 16, 1959, and February 1, 1960; and to your claim for refund filed on

July 31, 1956.

The issue raised in your claim for refund with respect to an additional bad debt has been allowed herein. However, other adjustments result in a deficiency. If a petition is not filed, a statutory notice of disallowance will be forwarded to you in accordance with the provisions of section 6532(a)(1) of the Internal Revenue Code of 1954.

A copy of this letter and statement has been mailed to your representative, Mr. LeRoy Katz, Ritz Building, Bluefield, West Virginia, in accordance with the authority con-

tained in the power of attorney executed by you.

[fol. JJ] Paragon Jewel Coal Company, Incorporated

Statement
Taxable Year Ended September 30, 1955

Adjustment to Income

Taxable income disclosed by amended return

\$182,153.89

Additional income and unallowable deductions:

(a) Royalties

\$33,986.65

(b) Depreciation

1,865.33

35,851.98

\$218,005.87

Nontaxable income and additional

aeductions:

Total .

(c) Depletion

17,883.55

Taxable income as adjusted

\$200,122.32

Explanation of Adjustments'

(a) It is determined that you are not entitled to a deduction in the amount of \$33,986.65 deducted as "overriding" royalties to C. A. Clyborne. The payments are in the nature of a distribution of earnings and, therefore, are not deductible under section 162(a) of the Internal Revenue Code

\$200,122.32

of 1954 or any other section thereof. Accordingly, taxable income is increased by said amount.

- (b) It is determined that the amount of \$27,937.31 represents a reasonable depreciation allowance to you for the taxable year ended September 30, 1955, within the meaning of section 167 of the Internal Revenue Code of 1954. Therefore, the amount of \$29,802.64 claimed in your amended return as depreciation has been reduced by the excessive deduction of \$1,865.33.
- (c) It is determined that you are entitled to a deduction of \$146,152.45 for percentage depletion on coal production for the taxable year ended September 30, 1955. Therefore, the amount of \$128,268.90 claimed in your amended return for said year is increased by the amount of \$17,883.55.

Computation of Tax

Taxable income as adjusted

Income tax liability (52% \$200,122.32 less \$5500.00) Income tax assessed, Origin Acct. No. CI 12-4819-55		98,563.61 96,034.32
Deficiency in income tax		\$ 2,529.29
[fol. KK] Paragon Jewel Coal	Company, Inco	rporated
Taxable Year	Statement Ended · Septem	ber 30, 1956
Adjustments	to Income	
Taxable income disclosed by turn Additional income and unallo		\$289,490.57
able deductions;	0	
(a) Royalties	. \$43,204,21	
(b) Depletion	.24,158.32	
(c) Depreciation	3,483.20	70,845.73
Total		\$360,336.30

Nontaxable income and additional deductions:

(d) Capital gains

272.52

(e) Loss from sale of other assets

353.10

625.62

Taxable income as adjusted

\$359,710.68

Explanation of Adjustments

- (a) It is determined that you are not entitled to a deduction in the amount of \$43,204.21 deducted as "overriding" royalties to C. A. Clyborne. The payments are in the nature of a distribution of earnings and, therefore, are not deductible under section 162(a) of the Internal Revenue Code of 1954 or any other section thereof. Accordingly, taxable income is increased by said amount.
- (b) It is determined that you are entitled to a deduction of \$201,074.96 for percentage depletion on coal production for the taxable year ended September 30, 1956. Therefore, the amount of \$225.233.28 claimed in your return for the said year is decreased by the amount of \$24,158.32.
- (c) It is determined that the amount of \$40,625.15 represents a reasonable depreciation allowance to you for the taxable year ended September 30, 1956, within the meaning of section 167 of the Internal Revenue Code of 1954. Therefore, the amount of \$44,108.35 claimed in your return as depreciation has been reduced by the excessive deduction of \$3,483.20.
- (d) It is determined that you realized a net gain from the sale or exchange of capital assets in the amount of \$5,926.10 for the taxable year ended September 30, 1956, in lieu of \$6,198.62 shown in your return. Accordingly, taxable income is decreased by the difference of \$272.52.
- (e) It is determined that you had a loss from the sale of property other than capital assets in the amount of \$5,179.93 for the taxable year ended September 30, 1956 in lieu of \$4,826.83 claimed in your return. Accordingly, taxable income is decreased by the difference of \$353.10.

[fol. LL] Paragon Jewel Coal Company, Incorporated

Statement

Taxable Year Ended September 30, 1956 Computation of Tax

Taxable income as adjusted Less: Net long-term capital gain	\$359,710.68 5,926.10
Balance	\$353,784.58
Partial tax (52% of \$353,784.58 less \$5,500.00)	\$178,467.98
Add: 25% of net long-term capital gain	• 1,481.53
Income tax liability	\$179,949.51
Income tax assessed, Original, Acct. No. CI 12 3350-56	143;361.47
Deficiency in income tax	\$ 36,588,04
Taxable Year Ended Septem Adjustments to Income	ber 30, 1957
Taxable income disclosed by return	\$405 ₀ 931.22
Additional income and unallowable deductions:	
(a) Royalties \$ \$46,665.22	
(b) Depletion 59,895.08	/
(c) Depreciation 3,095.85	109,656.15
Taxable income as adjusted	\$515,587.37

Explanation of Adjustments

(a) It is determined that you are not entitled to a deduction in the amount of \$46,665.22 deducted as "overriding" royalties to C. A. Clyborne. The payments are in the nature of a distribution of earnings and, therefore, are not deductible under section 162(a) of the Internal Revenue Code

of 1954 or any other section thereof. Accordingly, taxable income is increased by said amount.

- (b) It is determined that you are entitled to a deduction of \$265,595.89 for percentage depletion on coal production for the taxable year ended September 30, 1957. Therefore, the amount of \$325,490.97 claimed in your return for the said year is decreased by the amount of \$59,895.08.
- (c) It is determined that the amount of \$40,249.27 represents a reasonable depreciation allowance to you for the taxable year ended September 30, 1957, within the meaning of section 167 of the Internal Revenue Code of 1954. Therefore, the amount of \$43,345.12 claimed in your return as depreciation has been reduced by the excessive deduction of \$3,095.85.

[fol. MM] Paragon Jewel Coal Company, Incorporated

Statement Taxable Year Ended September 30, 1957 Computation of Tax

Taxable income as adjusted	\$515,587.37
Income tax liability (52% of \$515,-587.37 less \$5,500.00) Income tax assessed, Original,	\$262,605.43
Acct. No. CI 12 2327-57	205,584.23
Deficiency in income tax	\$ 57,021.20

[fol. NN] [File endorsement omitted]

Before the Tax Court of the United States

Docket No. 90766

[Title omitted]

Answer to Amended Petition-Filed March 1, 1961

The Respondent, in answer to the amended petition filed in the above-entitled case, admits, denies, and alleges as follows:

- 1. Admits the allegations of the first sentence of paragraph 1 of the amended petition. Denies the allegations of the second sentence of paragraph 1 of the amended petition. In further answer to the second sentence of paragraph 1 of the amended petition, respondent alleges that the returns for the periods here involved were filed with the District Director of Internal Revenue, Richmond, Virginia.
- 2 and 3. Admits the allegations of paragraphs 2 and 3 of the amended petition.
- 4. Denies the allegations of paragraph 4 of the amended petition.
- 5. A) through F) Denies the allegations of subparagraphs A) through F) of paragraph 5 of the amended petition.

3. ..

- A) Denies the allegations of subparagraph A) of Part I of paragraph 6 of the amended petition, except it is admitted that petitioner is a corporation organized under the laws of the State of Virginia, with its business office located in Bluefield, West Virginia.
- B) Denies the allegations of subparagraph B) of Part I [fol. OO] of paragraph 6 of the amended petition, except it is admitted that the president and principal stockholder of this corporation, which was incorporated in October, 1951, is C. A. Clyborne of Bluefield, West Virginia, who has been the president of this corporation since its formation.
- C) and D) Denies the allegations of subparagraphs C) and D) of Part I of paragraph 6 of the amended petition.
- E) Denies the allegations of subparagraph E) of Part I of paragraph 6 of the amended petition, except it is admitted that in October, 1951 the Paragon Jewel Coal Company, Incorporated was organized under the laws of the State of Virginia.

F), G), and H) Denies the allegations of subparagraphs F), G), and H) of Part I of paragraph 6 of the amended petition.

II

- I) through N) Denies the allegations of subparagraphs
 1) through N) of Part II of paragraph 6 of the amended petition.
- 7. Denies generally each and every allegation of the amended petition not hereinbefore specifically admitted, qualified, or denied.

Wherefore, it is prayed that the relief sought in the amended petition be denied and the deficiencies determined by the respondent be in all respects approved.

R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service.

Of Counsel: Clarence E. Price, Regional Counsel, Bart A. Brown, Jr., Attorney, Internal Revenue Service, 1201 Enquirer Building, Cincinnat, 2, Ohio.

[fol. 1]

BEFORE THE TAX COURT OF THE UNITED STATES

Docket Nos. 84122, 84123, 84124, 84125, 84126, 90765, 90766

ROBERT LEE MERRITT AND WINNIE MERRITT,
G. WESLEY MERRITT AND FANNIE J. MERRITT,
JACK D. MERRITT AND WILLA GRAY MERRITT,
VIRGIL BOWLING AND GLADYS BOWLING,
JAMES O. WATSON, 3RD AND LUCY J. WATSON,
C. A. CLYBORNE AND VERNICE H. CLYBORNE,
PARAGON JEWELL COAL COMPANY, INC., Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Before: Honorable William M. Drennen, Judge.

Excerpts From Transcript of Proceedings— November 6-15, 1961

[fol. 2/] APPEARANCES:

John Merrell, Esq., appearing on behalf of petitioners Robert Lee Merritt and Winnie Merritt, et al., Docket Nos. 84122, 84123, 84124, 84125 and 84126.

Leroy Katz, Esq., Bluefield, West Virginia; Carl C. Gillespie, Esq., Tazewell, Virginia; and Frederick Bernays Wiener, Esq., Washington, D. C., appearing on behalf of petitioners C. A. Clyborne and Vernice H. Clyborne, and Paragon Jewell Coal Company, Inc., Docket Nos. 90765 and 90766.

Bart A. Brown, Jr., Esq., Internal Revenue Service, Washington, D. C., appearing on behalf of respondent.

[fol. 3] The Court: Now, in accord with our pretrial conference in this case, I think I will just state for the record

the agreed procedure. And if I am wrong in any particular, will you just mention it when I finish.

[fol. 5] Now, on the depletion issue it is my understanding

that the respondent takes sort of a neutral position.

That would not deprive you of the right to put on rebuttal evidence if it seems necessary. But as I understand it, at present there is no plan on behalf of the respondent on any depletion issue.

Mr. Brown: That is correct, your Honor.

. [fol. 140] C. A. CLYBORNE was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Katz:

[fol. 170] Q. Now as to the royalty which is paid by the Paragon Jewel Coal Company for these properties which were transferred to it, to whom are those royalties paid?

Mr. Brown: If the Court please, I object to the use of the term "royalty" because that is the issue in this case.

The Court: Well, they are called royalties in the agreements at least, I suppose.

Mr. Katz: I don't think there is any question.

By Mr. Katz:

- Q. To whom are the royalties paid, Mr. Clyborne?
- A. Paragon pays the royalty to C. A. Clyborne.
- Q. Then what does C. A. Clyborne do with the royalty he receives?
 - A. Pays to respective lessors involved.
- Q. And when Mr. Franks is also receiving an overriding [fol. 171] royalty of two and a half cents who pays him?

A. I do.

Q. Now on all of these leases have you retained personally the liability for the minimum royalties?

A. Yes.

[fol. 176] Q. Now, Mr. Clyborne, you have been in the Buchanan area and producing coal in the Buchanan area for many years. Do you know the custom in the area for the payment of overriding royalties?

A. Yes.

Q. Are you familiar with that custom?

. A. Yes.

Q. Is there such a custom in the Buchanan County area?

A. Very prevalent.

Q. And the payment of an overriding royalty then is customary in that area?

Mr. Brown: I object, your Honor.

The Witness: Yes, sir, The Court: To what?

[fol. 177] Mr. Brown: To the leading questions again and again and again.

The Court: I think it would be better, Mr. Katz, if you ask him what the custom was rather than tell him.

By Mr. Katz:

Q. All right, what was the custom, Mr. Clyborne?

A. Ranges from 10 to 25 cents a ton.

The Court: What ranges from 10 to 25 cents a ton?

The Witness: It is a custom to override the royalties to rates 10 to 25 cents per ton, and your Honor, they are never put on record.

By Mr. Katz:

Q. You mean the overriding royalty?

A. The overriding royalty agreements in ninety percent of the leases are not put on record.

Q. In Buchanan County, Virginia?

A. Yes.

[fol. 184] Cross examination.

By Mr. Brown:

[fol. 223] Q. All right, let's talk about Brown number five.

A. Brown number five was purchased by C. A. Clyborne in 1952, and the Brown heirs number six, Paragon Jewel didn't have the money and they were in debt approximately \$300,000 at that time—

Q. Mr. Clyborne, do you mean to tell me-

Mr. Katz: I object, your Honor. He hasn't finished answering his question. He is interrupting his answer.

The Court: Let him finish the answer. Had you finished,

Mr. Clyborne?

The Witness: What did I say?

(The reporter read the previous answer.)

The Witness: Oh, and six months behind on the bills.

By Mr. Brown:

Q. Mr. Clyborne, how much did Brown number five cost? A. \$8,000.

[fol. 224] Q. And how much did Brown number six cost? A. \$8,000.

Q. You mean that a corporation that can borrow \$300,000 can't borrow sixteen?

A. It looked dark there for a while, gloomy.

Mr. Brown: I have no further questions.

The Court: All right. Redirect.

Redirect examination.

By Mr. Katz:

- Q. Mr. Clyborne, was there any reason for you to form a corporation to actually produce and to clean and process the coal instead of doing it yourself personally?
 - A. Yes.
 - Q. What was the reason?

A. The coal business is very hazardous and I was unwilling, having hit the skids twice, to spose what I had accumulated to the hazards of the coal business. I have known of friendly companies that had a million and a half dollars and three years later they were virtually broke. I know of one case where, or several cases that three, four, five million dollar companies went broke because of economics and because of wretched coal market conditions, and this was a new experiment and I was in an area that hadn't been too well proven.

There was one mine three miles away, but coal seams have a way of changing the characteristics sometimes over [fol. 225] distances of one or two miles, and I wasn't inclined to take unusual risks with what I had accumulated personally; and the seam ranged from four to thirty inches and I couldn't operate, I couldn't mechanize, and I evolved a method of building a processing plant and engaging the services of independent contractors and making allocations to them within practical means, and we were quite uncertain at the time whether that method of mining would, as a unit, work.

There had been prior to that time some operators that were primarily engaged in production, and they would select certain isolated areas for independent contractors to mine and bring coal to the tipple as supplementary to their main job.

But, as a matter of fact, most of my friends thought I was getting ready to wind up in the hands of the gentleman with the black sombrero.

Q. Well, at any rate, Mr. Clyborne, then the corporation was a means of isolating yourself, of course, from the dangers inherent in the coal producing business?

· A. That's right.

[fol. 227]

Recross examination.

By Mr. Brown:

[fol. 228] The Court: Mr. Clyborne, is Paragon Jewel an

operating company? Does it produce itself?

The Witness: No, sir, it is a processing company, your Honor, and we engage the services of approximately 32 contractors to—we make allocations around the mountain and each one hires, discharges his own labor, pays his own compensation, and brings coal to our tipple, and we pay them for the raw coal every two weeks. We used to pay every week. Then we run it through the processing plant [fol. 229] and make these various sizes appropriate for the market, and that constitutes—

The Court: All production is done by independent-

The Witness: Independent contractors, on the American

incentive/plan.

The Court: And I gather then that you have never been directly connected with a producing company, have you, in your—

The Witness: Oh, yes. Just back years ago as a general

manager of a small place.

The Court: But most of your experience has been in the . sales?

The Witness: Yes, sir, primarily. 46 years of it. I am saying now that I am a sales agent, wholesaler and processor.

[fol. 273] H. CLAUDE POBST was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Gillespie:

Q. Mr. Pobst, what is your business or profession?
A. Practice of law.

Q. Where do you engage in the practice of law?

A. Grundy, Buchanan County, Virginia.

[fol. 274] Q. How long have you engaged in the practice of law in Buchanan County, Virginia?

A. I passed the Virginia State Bar and became licensed

on June 10, 1906, 55 years ago last June.

Q. During that period of time, have you engaged in the practice of law in that county and area in behalf of coal companies?

A. I have. I practiced the first 13 years in Tazewell, Virginia, then in 1919, moved to Grundy, Buchanan County, Virginia, and have practiced there ever since. And am still practicing.

Q. Where is Tazewell County with relation to Buchanan

County?

A. It is the adjoining county.

[fol. 285] The Witness: The overriding royalty—and I am talking about the royalty in addition to the royalty actually paid to the land owner—will run grossly from 10 to 25 cents. And sometimes, it will be more than that. I think it would be more material to state, your Honor, and I don't believe I have stated that, that in many instances these leases to the people who mine the coal are oral and not in writing at all.

[fol. 303] HIRAM A. STREET was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Gillespie:

[fol. 313] Q. Mr. Street, the leases which Mr. Johnson secured that you have been testifying about, were they ever

actually reduced to writing and did they ever name H. J. Johnson as lessee in those leases?

A. The Hurt McGuire lease was never reduced to writing. As I have mentioned to you before, and in certain instances with certain people in Buchanan County, old residents, verbal understandings usually control and that particular lease was never reduced to writing.

[fol. 332] Cross examination.

By Mr. Brown:

Q. Mr. Street, what effect does the thickness of coal of a particular seam have on the price that you can receive for this seam of coal?

A. Up to a certain height, if the coal is higher and cleaner, you can mine it with machines and it would bring a better price. In other words, that is one of the factors that would affect price.

Q. How thick a seaming before it gets too thick, that

you can't use the machines?

A. You see, the difficulty is not getting too thick from the standpoint of using machines, but deals with being able to prop the roof up to prevent the mountain from falling in on you. To illustrate, the Clinchfield Coal Corporation has some coal which is reported to be 15 to 20 feet high, and they have these tremendous machines in there on hydraulic lifts, that cut the coal away and automatically [fol. 333] mine it at the rate of 100 tons per man per day, but when they start putting timbers up, major timbers that high, to hold the mountain off of you, that is where the difficulty comes in in height.

Now, the best coal, that is from the standpoint of miners mining in our section, that is what they generally like, is something around, I would say, 60 inches would be ideal, or in that section, because then they can get timbers for it, and without too much difficulty, they have better control and all.

Q. You mention there are several reasons why people don't record leases in Buchanan County. You mentioned one of them, what are some of the other reasons?

A. The one I mentioned was from the standpoint of land-[fol. 334] lords, what you lease it for. A second reason, under our state law, before an instrument can be recorded, it has to be acknowledged a certain way, and if not acknowledged, you can have two certifying witnesses, and then those witnesses have to be brought into the Clerk's Office and testify to the authenticity of the signature. Well, quite frequently in dealing with country people, if you go to make a deal, so to speak, and you have the man agreeing, you want to get his signature right then.

Now, if you wait around two or three days, he may find out somebody else would pay him a little more, and you would have a hard time closing, so a lot of the operators will have him sign, even without witnesses, or if they have one witness, they will have maybe the one witness sign, so there is a second reason the instrument by law cannot be recorded.

And then, some people we have, most of the coal that is independently owned, is owned by people who have lived in the county for generations. I come from maybe, I think my ancestors go back four or five generations in the one county. Well, my grandfather who is 93, he can be dealing with a man on a lease, and not at 93 they probably wouldn't take his word, but back when he was a younger man, knowing the man, and handshaking to a certain extent, is good. He goes in, starts mining, starts paying the check. If the [fol. 335] man dies, his heirs are only interested in the money and actually not even a lease entered into.

I can probably name you some more, but that gives you an idea of the factors that affect it.

[fol. 352] F. B. Fowler was called as a witness on behalf of the petitioner [Paragon] and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Gillespie:

- Q. Mr. Fowler, how long have you lived in Grundy, Virginia?
 - A. Since 1934.
 - Q. How long have you lived in Buchanan County?
 - A. Since 1934.
 - Q. What is your business or occupation?
 - A. I am a coal miner, coal operator.
- Q. What has been the extent of your activities in the coal mining business, Mr. Fowler?
- A. Well, I mine coal and manage three different shipping facilities, buy and sell coal.
- Q. And have you actually engaged in the extraction of coal inside the mines?
 - A. Yes, sir.

[fol. 355] Q. Are your leases both written as well as oral? [fol. 356] A. Yes, sir.

Q. What about your assignments or subleases?

A. All of those are oral.

Q. You have no written assignments or subleases whatsoever then?

A. No, sir.

Q. Now, from whom do you obtain your leases?

A. Well, I would say they are about 30-70, 30 percent from the land owners and 70 percent from people that have leased it up in the past, prior years.

Q. And to whom do you sublet these lands which you have

acquired?

A. To individuals and corporations.

Q. Are those individuals and corporations engaged in the actual production and processing of coal?

A. Yes, sir.

[fol. 383] J.P. Shockey was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Katz:

[fol. 387] Q. Those are the main leases. Now, Mr. Shockey, is it true or let me ask you this, does your company sublease any of these lands for the purpose of having the coal mined, in other words, are they leased out to producing coal companies?

A. Yes, sir, practically all of our mining is done by

contractors.

Q. And have you then subleased these tracts to these other companies?

A. Yes, sir.

[fol. 388] Q. Is that done by oral or written agreement?

A. All of my contracts are oral.

[fol. 389]

Cross examination.

By Mr. Brown:

[fol. 390] Q. I see. These some 40 contractors that you mentioned here in your testimony that you are subleasing to, how large are their operations?

A. Oh, they run from around 25 tons a day up to about 200 tons a day.

Q. What do they do with their coal after they mine it? A. Well, they have to bring the coal to our preparation, to the preparation plant of New Garden Coal Corporation [fol. 391] unless I haven't gotten new orders and then I tell them to take it somewhere else. We collect the royalty ourselves, what is brought to us, and then the owner prep-

aration plants to which they deliver, they collect the money for New Garden Coal Corporation.

[fol. 440] HARLAN WALLS was called as a witness on behalf of the respondent, and, having been first duly sworn, testified as follows:

[fol. 461] Cross examination.

By Mr. Gillespie:

Q. Mr. Walls, I believe you say that originally your tipple and cleaning plant was constructed out of used, or second-hand, material?

A. That is correct.

Q. Which was moved there from some other point, is that correct?

A. Yes. I am familiar with that point because I was [fol. 462] in charge of that particular tipple in Tennessee, and at the time that the operations were stopped there, then the Jewell Smokeless Coal Corporation purchased that property and—I mean, purchased the tipple from that property, and moved it to Virginia.

[fol. 487] Frank H. Woods was called as a witness on behalf of the respondent, and, having been first duly sworn, testified as follows:

[fol. 488] Direct examination.

By Mr. Brown: ..

Q. Mr. Woods, what is your position?

A. I am the Treasurer and General Manager of the Paragon Jewell Coal Company.

[fol. 490] Q. Isn't it true that your company has ceased to mine on the Tazewell Coal and Iron property in 1957 and 1958?

A. I think it was 1959, but we have ceased mining on it, ves. sir.

Q. And why was that?

A. Well, I explained to you, we opened, I believe it was eleven places on there, and all of these places proved faulty. The first place that was driven in was about four hundred feet and the highest coal we had was seventeen inches. The farther along we progressed, the mining conditions got so bad that it was just impossible to keep anyone in there at the mine. A lot of them had a lot of water.

The top was bad, what we speak of as rotten top, and the conditions were so that we couldn't keep anyone there [fol. 491] that would mine the coal.

Of all the properties that we have, that was the worst mining conditions of any. For instance, one time, we had about fifteen or sixteen inches of coal and twenty-four inches to thirty inches of rotten top that would come on top of the coal. Before you could remove the coal, you had to remove the rot.

[fol. 497a] C. A. CLYBORNE was recalled as a witness on behalf of the respondent, and, having been previously duly sworn, testified further as follows:

Cross examination.

By Mr. Brown:

[fol. 502] Q. Now, Mr. Clyborne, isn't it true, with respect to the properties that we have involved in this case, that during the period that you held them in your name, before transferring them to Paragon Jewell, that you did nothing [fol. 503] to prove the raven seam on the particular properties?

A. I did nothing to prove the seam?

Q. Yes.

for local use, and I don't recall the extent of the prospecting that was done. It is too long ago.

Q. You didn't pay anybody to do any prospecting, did

you?

A. If the books reflect it, I did.

- Q. And that would be on your personal books and records?
 - A. Yes.
- Q. You did nothing to develop the properties, did you, during that time? Build roads? Power lines? Anything like that?
 - A. No, there was not any occasion to do that because-
 - Q. You didn't face up the outcrop, or anything like that?

 A. We may have faced it up, and the books will disclose it.
- Q. And your personal books will show any expenses that you incurred in connection with that.

Mr. Clyborne, will you describe the Jewell seam of coal as a predictable seam?

A. A predictable seam? [fol. 504] Q. Yes, sir.

A. To this extent, that it is—it ranges from, in the Whitewood area, from thirty inches down to two inches, and in some places pinches out entirely. We, in the industry, have always regarded it as an irregular seam, and a very thin seam.

Q. In other words, you would class it then as an unpredictable, rather than a predictable seam, wouldn't you?

A. I thought you said I would regard it as unpredictable. You see, with reference to the location, you may have thirty inches here (indicating) and thirty feet away, you may have ten inches.

That is unpredictable from my standpoint.

Q. Yes.

A. But we do know it to be irregular.

Q. Will you explain to us again why you decided to conduct the operation by means of a corporation, rather than personally?

A. The coal business, in history, will show it, that it is highly hazardous, and since I have been in the business in 1940—I mean, since 1915, hundreds and hundreds of companies have gone broke, and the factors of the market-no market, curtailed market, unpredictable seams, qualityvariation in quality-it is a very uncertain business, and I would not attempt, with what little accumulations I had, [fols. 505-506] at that time; to expose it to the hazards of the production end, particularly a thin seam of coal, where you could not mechanize, which could not be mechanized, and which it was necessary to develop by hand-loading.

The risk was unusual, although we realized the quality of coal was tops—one of the most outstanding coals in the

world, but thin and difficult to mine.

Q. Now you say that you considered the risks unusual. What do you mean by that?

A. Hazardous.

Q. Unusual?

A. Extremely hazardous.

Q. To what extent had this thirty-inch Jewell seam been

mined prior to Paragon Jewell's operations?

A. Only by the Jewell Ridge Coal Corporation, and in that area they had from thirty-two inches to a high of five feet.

Q. Now what-

A. They invaded that area in 1910. They were pioneers in that area, and had a complete lock on the situation there from 1935 or 1936 up until 1945.

Q. You wouldn't consider the seam of coal that they were

mining as a thin seam?

A. It was known as relatively thin, but there is, in the area in which they cover, five miles away, the coal was [fol. 507] thicker, and they could mechanize to a limited extent.

Q. Were you the first one to actually attempt to mine this twenty-six to thirty-two inch seam?

A. In a major way, yes.

Q. You also mentioned that you were a pioneer in a large-scale contract mining operation. What do you mean by that?

A. Up until that time conventional operators had, from time to time, engaged the services of independent contractors in isolated areas to bring the coal to the tipple, which was utilized primarily to mine their own coal, but these isolated areas where these contractors were engaged and the production was supplementary to the main body of the coal operated by the producing companies.

Up until that time, no other independent had attempted to build a tipple and engage, exclusively, the use of independent contractors to mine coal and deliver the raw coal

to the tipple.

We had no certainty that independent contractors would be available. We—being optimistic, we expected that some would be available from these other areas that had been operating in a partial way on other conventional mining properties.

[fol. 508] Q. Was your method of operation, of using exclusively contract miners, was that considered hazardous by the professionals in the coal mining field?

A. I regarded it as hazardous. I do not know of any professionals who undertook it, except normal mining in a

small way at Seabord, Virginia.

Q. So then you were the real pioneer of this type of operation?

A. In a major way, yes.

[fol. 586] Mr. Brown: If the Court please, I think originally I am, on behalf of the government, to make a brief opening statement setting forth the government's position and then the parties will go forward with their opening statements and proof.

[fol. 587] The issue in this case is whether under these [fol. 588] oral contracts Paragon Jewel passed an economic interest in coal in place to these various coal companies.

Respondent's position in these particular cases is that one of the parties is entitled to the percentage depletion deductions in question. Both cannot be entitled to it since

both are claiming percentage depletion to the same amounts

of mining income.

Both parties are represented by counsel, both of the real parties in interest, Paragon Coal and the coal companies, and respondent believes that under these circumstances it is appropriate that it remain neutral insofar as the trial of this case is concerned, and we intend to do so.

[fol. 612] C. A. CLYBORNE was recalled as a witness on behalf of the petitioner [Paragon], and, having been previously duly sworn, testified as follows:

[fol. 613] Direct examination.

By Mr. Gillespie:

[fol. 621] Q. Did you have any other employees on the job, Mr. Clyborne?

A. We had a superintendent.

Q. And what were the engineer's duties?

A. Initially to engineer the contours of the outcrop, to determine the acreage in each tract, and then he would confer with the contractors from time to time on projections and change of projections and set the spads and do the engineering inside the mine.

Q. Now you say that after you made your complete preparations to begin producing coal you got contractors. Did you or your company make written contracts with these

contractors initially or not?

A. No.

Q. They were all verbal contracts?

A. That is true.

[fol. 622] By Mr. Gillespie:

Q. You stated you had a superintendent. Who was that, Mr. Clyborne?

A. L. P. Gregan.

Q. Where is he at this time?

A. He died within the past year.

Q. How long was he superintendent at this operation?

A. As I recall, it was three to four years from the inception of the work.

Q. And who was it that personally negotiated these verbal contracts with these mines?

A. Mr. Grogan.

Q. Was he given any authority from you or other officials of Paragon Jewel Coal Company relative to the terms of this contract?

A. Yes.

Q. Will you state what his authorization was?

Mr. Merrell: I object. I would like to first know if that authorization is in writing, if there is a written authorization.

By Mr. Gillespie:

Q. Was it written or verbal authorization?

A. Verbal.

[fol. 623] By Mr. Gillespie:

Q. In order to satisfy Mr. Merrell, will you state what Mr. Grogan's instructions were with relation to the terms of these verbal contracts with the truckman operators who came there to mine the coal?

A. In discussions we formulated a policy, and that was to engage the services of the contractors if, as, and when they were available, and in collaboration with them, the engineer, insist on choosing a location.

Q. What do you mean by a location?

A. Where the work would begin. Mr. Grogan would go up and show the contractor the various openings and it would be a matter of choice with them sometimes, particularly the first few that appeared on the scene looking for an engagement.

Q. All right, go ahead, Mr. Clyborne.

A. And the policy was to tell the contractors that they would mine the coal, take their depreciation, and we would

get the depletion because it was our coal, and subsequently [fol. 624] they would bring in their equipment, the equipment which they bought and had already bought from a prior engagement on some other job, and they would start to work.

[fol. 625] By Mr. Gillespie:

Q. What compensation were these contractors to receive from Paragon Jewel Coal Company for mining this coal?

A. At the outset we paid \$4 per ton extractive fee for

raw coal delivered to the surge bin or the tipple.

Q. Well, has the basis of payment been changed since that time to the present date?

A. Yes, up and down.

Q. You mean the amounts have been changed?

A. The amount of the price we paid varied from time to time.

Q. But has the basis for compensating these operators been changed? Are they still paid on a tonnage basis?

A. They are paid on a tonnage basis for the coal de-

[fol. 626] livered to the tipple.

- Q. And I believe you stated that that has gone up and down during the years that have ensued since this operation started?
- A. We pay them on a tonnage basis less two and a half percent for scale percentage reject. The washer rejects a substantial amount of impurity arising from the mining of the coal. Sometimes top gets into the coal, sometimes bottom, and sometimes both top and bottom.

· Q. Mr. Clyborne, how long were these verbal contracts to continue between Paragon Jewel Coal Company and the

contractors?

A. The policy as stated to Mr. Grogan was to terminate at will by either party.

[fol. 627] A. The policy was to have the coal delivered to our tipple exclusively unless by specific consent that in some

cases they had a little outcrop coal that they could dump over the hill, and we permitted them to do that.

Q. In other words, rash things of that kind?

A. That is unmerchantable. It was completely outcrop.

Q. Of course, when I speak of the coal I usually mean coal that was expected to be sold on the market.

A. Merchantable.

Q. Has any of that type of coal ever been permitted to be taken any other place than your company's tipple?

A. Not that I recall. I don't know of any occasion.

Q. None has ever been delivered anywhere else to your knowledge?

A. That's right.

[fol. 629] Q. Now at the time Paragon formulated the policy which you have been testifying about and instructing Mr. Grogan with relation thereto was he ever instructed to make any different agreement with any of these contractors, or were they to be uniform?

A. Uniform throughout. That was the policy that was formulated.

Q. Mr. Clyborne, you have testified that these contractors were paid a fixed price per ton for mining this coal for your company. What was the basis upon which that price was fixed or what were the considerations which entered into a determination of the amount of that price?

A. We considered our investment, we considered the market, and we also considered the fact of depletion, and arrived at the price based on the fact that we would get the depletion. We were more liberal because of these factors, with particular reference to depletion. We were paying four dollars a ton when others in the over-all general area were paying 25 to 50 cents less.

Mr. Merrell: I object. It is not responsive and there can be a difference in the problems of mining. One seam of coal is easier to mine than another, and I move to strike this as not responsive.

[fol. 630] The Court: Well, I believe the question that was asked was the basis upon which Paragon Jewel set the price, and it was my impression he was testifying to what

the Paragon Jewel took into consideration. I realize that there might be different operating conditions which would have a bearing on the price, but as long as you limit your testimony to what Paragon Jewel took into consideration in fixing the price—

The Witness: Yes, sir.

By Mr. Gillespie:

Q. That is what I asked you, Mr. Clyborne, and of course if you will just confine your answer to the considerations which your company, Paragon Jewel Coal Company, took into account in arriving at this price.

Mr. Clyborne, was there anything in the price which your company paid these contractors that was tied into the

market price directly or not?

A. Wasn't tied in directly. We considered the over-all market conditions and paid the contractors the best price that we could afford, and they always knew when they delivered coal to the tipple the price they would receive.

[fol. 633] By Mr. Gillespie:

Q. Mr. Clyborne, the leases of Paragon Jewel Coal Company have been introduced in evidence in this case, and they provide that the lessees are required to mine 85 percent of the merchantable, mineable coal. Who is obligated under that provision of the lease?

A. Paragon.

Q. Do you know of any other person, firm, or corporation who has any obligation whatsoever to the landowners for royalties, land taxes, mining 85 percent of the merchantable [fol. 634] coal or performing any other of the requirements of those leases?

Mr. Merrell: I object, your Honor. That is too general—they are obligated to mine S5 percent. I maintain that they obligated my people to mine all merchantable and mineable coal, and there is a question of whether my people's obligation would go through to the landowners.

The Court: Well, are you objecting because this is sort of a multiple question?

Mr. Merrell: Yes.

The Court: He does ask a lot of things in it. The answer might be different as to each one of them. I realize you are just trying to save time, but I think you better take them one at a time.

By Mr. Gillespie:

Q. Mr. Clyborne, is there any other person, firm, or corporation who is in any way or in any manner obligated to pay any part of the royalties to the landowner for this coal?

The Court: Do you know of any?

The Witness: Answer?

The Court: Yes. The Witness: No.

By Mr. Gillespie:

Q. Is there any other person, firm, or corporation that is obligated in any way, in any manner, for any part of [fol. 635] the taxes upon these lease hole lands?

A. No.

Q. Is there any other person, firm or corporation in any way or in any manner obligated to recover 85 percent of the mineable coal underlying these lands?

A. No.

[fol. 638] Q. To your knowledge, has he or any of his assistants ever laid off or surveyed in the specific tract or area upon your company's leasehold for the purpose of giving such tracts or area to any of these contractors so that they can remove all the mineable coal from it?

Mr. Merrell: Objection. That is so broad and it is not shown that he has any specific knowledge of what the engineer does from day to day.

[fol. 639] Judge Drennen: Well, it seems to me if he

simply says to his own knowledge this has never been done, it doesn't prove it hasn't been done. It proves that he doesn't know.

Mr. Merrell: All right. I will withdraw the objection.

Judge Drennen: You may answer.

The Witness: May I have it?

(The pending question was read by the reporter.)

The Witness: Yes.

By Mr. Gillespie:

Q. Did you understand the question?

The Witness: Read that over again, please.

(The pending question was reread by the reporter.)

The Witness: No.

By Mr. Gillespie:

Q. To your knowledge, have any of the contractors who have been engaged to mine the coal from the Paragon Jewel Coal Company's lands ever been required to mine all of the mineable coal from any specific tract or area?

A. No.

Cross examination.

By Mr. Merrell:

[fol. 642] Q. So in 1951 and 1952 Paragon Jewel was seeking production of coal, was it not?

A. Yes.

Q. In fact, it had already decided to rely exclusively on independent contractors, had it not?

A. Yes.

Q. And you were seeking independent contractors?

A. What was that?

Q. You were seeking independent contractors?

A. Yes.

Q. And you wanted people who would do a good job for you?

A. Yes.

Q. Have the Stillwell Brothers done a good job for you?

A. Yes.

Q. Have these other companies that I have mentioned produced a substantial amount of coal for you?

A. So far as I know, they have.

Q. And it was your policy of your company to encourage them to produce coal, was it not?

A. Quite so.

Q. And to make the investment and effort that was necessary to produce coal.

A. That is right.

[fol. 644] Q. Now, is it not true that Paragon Jewel has always taken all of the coal which the operators I have mentioned—

A. What was that second word?

I didn't hear you.

Q. Is it not true that the Paragon Jewel Company has [fol. 645] always taken all of the coal which the various operators that I have mentioned mined?

A. To the best of by knowledge, we have.

Q. You don't—to your knowledge they have never refused to take any of their coal.

A. We have never refused?

Q. Yes.

Well, have you ever refused to take any of the coal?

A. When they attempted to deliver out crop, very inferior coal, we wouldn't take that.

Q. Why wouldn't you take it?

A. Because of its inferior quality.

Q. Why don't you want inferior quality coal?

A. Well, we have a standard of quality to maintain with the commercial buyers and by-product plants abroad and in this country.

Q. Why didn't Paragon Jewel want to go into the production of coal?

A. We preferred the American incentive plan of the less fortunate people having an opportunity to make something substantially for themselves.

Q. You preferred to let someone else take that responsibility and reap the rewards or sustain the risk, is that right?

A. That is right.

[fol. 646] Q. Is it not true, Mr. Clyborne, that when these contractors made an agreement with you, that you allocated a particular area of coal to each contractor?

A. No.

· Q. You never allocated?

[fol. 647] A. The policy was to take the potential independent contractor to one of various locations and have him make a selection, and to that extent we designated the place that they would start, the opening that they would start.

Q. I see.

A. And they took off from that point.

Q. Well, didn't you allocate an area of coal so they could make their plans?

A. Not a boundary, exclusive boundary. Just so they

could get started because-

Q. You just gave them entrance in the side of the mountain?

A. That is right.

Q. And they had no basis for planning how much equipment they wanted to put in?

A. The engineer would make the projections for them up to a certain point.

Q. Well, he would give them-

A. And they were flexible. They would change it from time to time.

Q. He would allocate an area to them?

A. We designate an area, or if you prefer the word allocation, I suppose that is a synonym.

Q. He would designate an area for each contractor?

A. Designate a temporary—an area that they could take off and then the projections would be made.

[fol. 648] Q. I am asking, did the independent contractor when he started into the mountain, did he have a designated area of coal?

A. He has a flexible area.

Q. But no designated area of coal.

A. No specified designated boundary of coal, no.

Q. Now, is it not true that the prices which you paid the various contractors were based upon the market price of coal?

A: Indirectly.

- Q. Did you pay them according to the market price of coal?
- A. No. We agreed with them on a price. Or, rather, we stated what price we would pay and that price continued until there was some change in the market substantially, then we would raise it or lower it.

Q.-In accordance with the market.

A. Indirectly.

Economics enter into this, too, you know.

Q. You take what-

A. Economics entered into this.

Q. Well, economics would enter into the market, I am sure.

A. But the contractor always knew what price he would receive when he delivered coal to the tipple.

Q. Did he know what price he would receive for the coal that was still left in the mountain?

A. There is no obligation on his part to assume that responsibility. That was ours.

[fol. 663] Q. Now, you testified that you paid wheelage for coal brought across a little piece of land called the White land, is that not right?

A. That is right.

Q. What was the amount of the wheelage you paid?

A. 21/2 cents.

Q. 2½ cents a ton for coal brought across the White tract?

A. That is right.

Paragon Jewel is not involved in that.

Q. Paragon Jewel is not involved in that?

A. Except that they deduct the money to pay C. A. Clyborne.

[fol. 664] Q. They deduct what money?

A. They deduct from the contractors, deduct from that total.

Q. Oh, you require the contractor to pay the wheelage.

A. That is right. But they have a choice of coming across, 16 miles across—I mean, across the mountain at a haulage cost of 90 cents in the summer, a dollar in the winter.

Q. They are paying the 2½ cents a ton?

A. They elected to come this other way, across the White.

Q. So they cross the White tract and pay the $2\frac{1}{2}$ cents a ton wheelage.

A. Pay 5 cents.

Q. And you remit 21/2 of it the Whites.

A. That is right.

Q. In other words, you keep 21/2 override on wheelage?

A. That is right. The negotiations-

[fol. 666] Q. On the power line that you constructed, you received a reimbursement from the Appalachian Power Company for your outlay in installing that power line, did you not?

A. I don't recall whether we did or not. The books would

reflect it if we did.

Q. I see.

The Standard Smokeless Company has mined on your property continuously since they started, have they not, that is on the property of Paragon Jewel?

A. So far as I know.

Q. The same with these other companies that I have indicated?

[fol. 667] A. What other companies have you indicated?

Q. Far West?

A. Yes.

Q. Kyva, in a period of time until they had exhausted the mineral available to them, did they not?

Mr. Gillespie: We object to the form of the question, Your Honor.

By Mr. Merrell:

- Q. Do you know whether Kyva is still mining there or not?
 - A. No, I do not.
 - Q. Do you know if Sally Mining Company is?
 - A. I believe that they are still there.
 - Mr. Merrell: Nothing further.

Redirect examination.

By Mr. Gillespie:

[fol. 668] Now, there has also been some testimony about the who age which you received for crossing the White tract and that which was charged to the contractors who used that White tract. .

- A. That is right.
- Q. Who acquired the easement across the White tract?
- A. I did.
- Q. Did Paragon Jewel Coal Company have anything to do with the acquisition of that easement?
 - A. No.
- Q. Now, was there another means which Paragon Jewel Coal Company had provided for the contractors to get their. coal to the tipple other than crossing the White tract?
 - A. Yes.
- Q. Were the contractors who have used the White tract given the option to use that tract to get their coal to your tipple?

[fol. 669] A. They could use either route.

[fol. 673] CAUDLE BELCHER was called as a witness [for Paragon] and, having first been duly sworn, was examined and testified as follows:

Direct examination.

By Mr. Katz:

[fol. 674] Q. What is your connection with the Paragon Jewel Coal Company?

A. I do their engineering inside the mines and outside

them.

Q. How long have you been employed by the Paragon Jewel Coal Company?

A. Since some time in 1951.

Q. Is that from the very beginning of the corporation and its development?

A. Yes, sir.

[fol. 678] Q. Now, Mr. Belcher, at that time when they started to work, how far could they go into that mine?

A. Well, at that time we didn't know how far they could

go.

Q. Will you please explain to the court why you didn't know how far they could go into that mine?

A. We didn't know what would be the local conditions inside.

Q. Now, when you start a mine, what is your job as an . engineer?

Just what do you do?

A. Well, after it is opened up, you put your projections on and give them something to drive by.

Q. Now, what do you mean by projections, Mr. Belcher?

A. It is small lines put on a map showing how wide apart you are going to drive the entries.

Q. Do the projections determine the boundaries of a man's mine?

A. No, sir.

Q. Are those projections at any time absolute?

In other words, do they remain the same at all times or can they be changed!

[fol. 679] Mr. Merrell: Objection, Your Honor. He is leading the witness. He can ask him what the projections are, but he is trying to fasten them down to just what he wants.

Judge Drennen: I think it is a leading question.

Mr. Katz: I will rephrase the question.

By Mr. Katz:

Q. Mr. Belcher, just how do you do you work the projections? How are they put on the map?

A. You put so many lines on the map as to the number of places they can work and you turn them in a general

direction of the boundary of coal.

Q. Now, was there any other map in existence at the time that the Stillwell Brothers or Bare Ridge Coal Company came on the land to start operation of their mine?

A. Not as I know of.

Q. And, of course, you were the engineer in charge.

A. Yes.

Q. Now, all of this outside work that is done insofar as the surveying, who pays you for that?

A. Paragon Jewel Coal Company.

Q. And for the work that goes on inside the mine, that is, insofar as the engineering is concerned, who pays you for that?

A. The contractors.

[fol. 684] By Mr. Katz:

Q. Do you determine in which direction these mines will gof

A. Yes. sir.

Q. And now, Mr. Belcher, how do you determine in which direction they will go?

A. When you put your projections on the map back towards the body of the coal.

Q. And is that the direction that they will travel, then? Is that correct?

A. Yes, sir.

Q. Well, now, why is it at 1-K here, for example, you have a projection going to the right and one to the left?

· A. To give them more places for tonnage.

- Q. Now, I notice that there is another entry. Will you please mark that with a 3? I believe you stated you do not know the name of the mine that was operating there at the time?
 - A. No, sir.

Q. Now, please explain in what direction that mine that you have marked with a 3, what direction that was going.

A. That is going back parallel with Mine 1-K.

[fol. 685] Q. About how much space is between the two

mines?

A. About 400 feet.

Q. And what do you do with the projections with respect to that mine number 3, Mr. Belcher!

A. You turn straight in the mine and turn in places to

the right.

- Q. Is it necessary to keep mine 1-K and mine 3 separated?
 - A. Yes, sir.

Q. Why?

A. Well, because of the state law and ventilation.

Q. Now, what is it that you keep between the two to keep them separated, Mr. Belcher!

A. You can put a dotted line on the map and when they

approach that, you stop them.

Q. You stop them. And is that dotted line permanent?

A. No, sir.

- Q. Now, Mr. Belcher, what happens if mine number 3. quits or did mine number 3 quit that you have marked number 3?
 - A. Yes, sir.

Q. What would happen with Mine Number 1-K in the event that Mine Number 3 quit?

A. Well, you drive some other mines through, mine them, and you would mine the coal.

Q. In other words, it changes so that you can pick up the coal that the other mine did not get, is that right? [fol. 686] A. Yes, that is right.

[fol. 688] Q. I will ask you. Mr. Belcher, whether or not this map shows any specific area or boundary of coal which any particular mine has the right to mine to exhaustion or—

A. No, sir.

[fol. 698]

By Mr. Katz:

Q. Well, how do you stop them from mining into each other, Mr. Belcher? Or how are they stopped from mining into each other?

A. I tell them to stop or make a map and show them where the other mines are, to keep them from coming together.

Q. And that is done on the basis of the maps which you prepare?

A. Yes, sir.

Q. And do the spads have anything to do with that?

A. No, sir. When you stop them, you don't set no more spads.

Q. In other words, when you stop setting spads, they have got to stop, is that it?

A. That is right.

Q. Is there anything on this map-

A. That is right.

[fol. 699] Q. Is there anything on this map, Mr. Belcher, which gives any particular mine any particular area of coal which they can mine to exhaustion?

A. No, sir.

[fol. 703] Q. Now, Mr. Belcher, I note that some of these mines extend a long way and some go a relatively short distance. Will you please explain how that comes about?

A. Well, some of them hit rolls and they can't mine the coal. The others hit water or a bad top condition and they pull out.

Q. You mean they just leave?

A. That is right.

Q. What direction is the Stillwell mine going on this map?

[fol. 704] A. It goes behind the 5 other mines.

Q. Who determines who will get the coal between the Stillwell Mine and the 5 mines in back of it, if you know?

A. Well, Stillwell has got the most of it.

Q. In other words, he has already got most of it?

A. Yes, sir.

Q. Is there any specific boundary or area shown on this map which any of these mines could mine to exhaustion?

A. No, sir.

Q. Have the projections which are shown on all of these maps ever been changed?

A. Yes, sir.

[fol. 708] Q. Mr. Belcher, throughout the time that you have been there, have you at any time ever set out any specific area that any of these miners could mine to exhaustion?

Mr. Merrell: I am going to object to this. The question has been asked several times and he wasn't a party to the negotiations between the contractor and Paragon Jewel. He was an engineer, paid partly by Paragon Jewel and partly by the contractors.

Judge Drennen: The question is simply what he has

done.

Mr. Merrell: What he has done on a physical document like a map?

Mr. Katz: Yes, or anywhere.

Judge Drennen: Well, yes, I gather that is-

Mr. Katz: It is whether or not he has ever surveyed off or blocked off any specific area for any of these miners to mine to exhaustion.

about, Mr. Merrell. He is the engineer in charge.

Mrs Merrell: Whether he has done that on a map, is

that your question?

Mr. Katz: Whether he has done it on a map, on the land or anywhere else.

Mr. Merrell: All right. No objection.

By Mr. Katz:

Q. Have you ever done that, Mr. Belcher? [fol. 709] A. No, sir.

[fol. 725] C. B. Belcher resumed the stand, and having been previously duly sworn, testified further as follows:

Further direct examination.

By Mr. Katz: 00

Q. Mr. Belcher, at the conclusion of the testimony on Friday you were still on the witness stand and we were asking you questions in connection with the contract which you entered into in 1955 with Mr. Woods at the time that you, yourself, started operating as a contractor on the Paragon Jewel lands. Do you recall that, sir?

A. As to the terms of the contract you mean?

Q. Yes, sir. Do you recall that, that we were discussing that?

A. Yes.

[fol. 726] Q. Now according to the terms of that agreement when were you to receive the money for the coal which you delivered to Paragón Jewel Coal Company?

A. They would keep us two weeks behind at the begin-

ning, the best I remember.

Q. At any time after you had mined the coal and delivered it to the Paragon tipple could Paragon Jewel Coal Company refuse that coal?

A. No, sir.

Q. They were then required to pay you the agreed price or the agreed amount per ton?

A. Yes, sir.

[fol. 727] Q. Mr. Belcher, could Paragon Jewel Coal Company change the amount they paid you per ton or the amount that you received for mining the coal after you had actually mined the coal and delivered it to the tipple?

A. No, sir.

Q. Whom did you rely on to receive your money that you were to receive for mining the coal?

A. Paragon Jewel Coal Company.

Q. Did you know what price Paragon Jewel Coal Company received for mining that coal—I mean for selling that coal?

A. No, sir.

Q. Did they ever furnish you any kind of report as to what price they received for their coal?

A. No, sir.

[fol. 728]

By Mr. Katz:

Q. What, if anything, was said with respect to the termination of this contract?

A. Not anything to my remembrance.

Q. What was your understanding, if any, as to the rights to terminate this contract?

Mr. Merrell: I object, your Honor. He said that nothing was said about termination. That was his answer.

The Court: Well, but he has a right to state what his understanding was as part of the contract. I will overrule the objection.

By Mr. Katz:

Q. Will you answer that? What was your understanding as to the right of termination?

A. Well, so long as there was coal to mine you don't feel that there would be any termination.

[fol. 730]

Cross examination.

By Mr. Merrell:

Q. Now as I understand it, you are paid by Paragon for the outside engineering work?

A. Yes, sir.

[fol. 731] Q. And by the operators for the inside engineering work?

A. Yes, sir.

Q. And you are a mining engineer?

A. Yes, sir.

Q. Also a coal mine operator, is that right?

A. Yes, sir.

Q. What is the exploration stage of a coal mine?

A. I don't believe I get what you mean by that?

Q. What is regarded in the coal industry as the development stage of the coal mine?

A. I don't quite understand that.

Q. When you first start a coal mine operation are you able to produce a large amount of tonnage right at the beginning?

A. No, sir.

Q. It takes you some time to develop a mine until you get up to a certain tonnage, does it not?

A. That's right.

Q. And you have to plan your operation so that the mine is properly developed do you not?

A. Yes, you lay out the mine.

- Q. And then when you have laid it out and operate it and developed a sufficient area of places for men to work then your tonnage increases, does it not?

 [fol. 732] A. Yes, sir.
- Q. And that was true in the mine which you had on the Ritter property?

A. Yes, sir.

Q. And also on the mine which you had on Paragon Jewel's property?

A. Yes, sir.

Q. Now this seam of coal, the Raven Red Ash seam underlying the Paragon lease, is a difficult seam of coal to work, is it not?

A. In areas, yes.

Q. What causes the difficulty primarily?

A. You have rolls and falls.

Q. Rolls and falls is where the coal narrows down and you are concerned more with sandstone than you are coal. is that not true?

A. Yes, sir.

Q. Now what are pillars in a mine?

A. That is the coal you leave as you develop the mine.

Q. What is the purpose of leaving a pillar?

A. To protect the roof.

Q. To hold the roof up? A. Yes, sir.

Q. What other measures do you take in mining to hold the roof up?

[fol. 733] A. Timber.

Q. What happens if the roof falls down?

A. You remove the roof out of the entry.

Q. You remove the what?

A. The roof out of the entry of the tunnel.

Q. I mean if you did not leave these pillars what would happen to the mine?

A. The roof would come down.

Q. Would it then be a workable mine?

A. No, sir.

[fol. 745] By Mr. Merrell:

Q. Now you testified yesterday that you could not let these mines run together because it would be unsafe and disturb your ventilation. I notice here that mine number six, which has been identified by you as the Kyva mine, has run into mine number seven. Do you know why those two mines ran together?

A. No, sir.

Q. You don't?

A. Just drove them together.

Q. Who drove them together?

A. I don't remember, but Kyva Coal Company I think, bought out the other mine. When, I don't know.

Q. This was a mine that belonged to Sampey Lester, was

it not?

A. I think he started the ntine.

The Court: It is number seven you are talking about? Mr. Merrell: Number seven.

By Mr. Merrell:

Q. And the Kyva Mine bought out Sampey Lester's mine, is that not right?

A. Yes, sir.

Q. And then they were permitted to run into Sampey [fol. 746] Lester's mane and mine it as one mine, were they not?

A. I think they did, yes.

Q. Now if you can recall, who was operating in mine number nine at the time this map was made?

A. Sherman Meadows.

Q. And mine number eight?

A. That is Sherman Meadows.

Q. Now I ask you to identify this little line that is marked A, starting at the left of mine number eight. Can you see it, Mr. Belcher?

A. Yes, sir.

Q. The line that runs down past mine number seven, turns and runs on over here.

The Court: Westerly direction.

By Mr. Merren:

Q. Westerly direction, and then turns right and runs in the direction of the McNeil property. What is that line?

A. That was a line to leave a barrier between mines.

Q. In other words there was the barrier between Mr. Meadows' two mines on the right and mine number seven and mine number six and mine number five, is that not right? They were to run up to this line?

A. If they could get there, yes.

Q. But they had the right to go to that line if they could get there?

[fol. 747] A. Or further.

Q. I thought you said it was a barrier.

A. Well, if the other man pulled out then the barrier would be shifted to some other place.

Q. If the other man pulled out like Mr. Lester did ever there the barrier might be shifted, right?

A. That's right.

Q. Now the number six has been identified as the Kyva mine, number five as the Standard Smokeless mine. Now I take you over to the left side of the map, and there are some workings here indicating Bare Ridge Coal Company, and they are driving in a northeasterly direction, are they not?

A. Yes, sir.

Q. And this dotted line A was a barrier for them also, was it not?

A. If they could drive that far, yes, sir.

Q. If they could drive that far they could get the coal up to that barrier, could they not?

A. Yes, sir.

Q. And Meadows driving this way could also drive up to the barrier if he could get the coal?

A. If he could get the coal.

[fol. 753] By Mr. Merrell:

Qo Now I show you a line on the right of the map, right of mine number ten, which is indicated B, and ask you to tell me what that line represents?

A. That was a line put on there to give them so many

places to drive over to it.

Q. And then they were supposed to stop at B, is that right?

A. If they could mine it, yes.

Q. If they could get there they could go to B?

. A. Or farther, yes.

Q. What do you mean "or farther"? Could they go farther than B if this other man was still working?

A. Well, it would depend on the amount of coal they would mine.

[fol. 754] Q. Is anyone working in either of these mines at this time, and if you want to check the dates, do so. I am referring to mine number ten and mine number eleven. Was anyone working in these mines at the time this map was made?

A. No, sir, not to my knowledge they were not.

Q. Are you acquainted with the fact that the Far West Coal Company purchased mine number eight and nine which were operated by Sherman Meadows?

A. Yes, sir.

Q. They did purchase them?

A. Yes, sir.

Q. Now after they purchased mine eight and nine did they later obtain the right to mine the coal clear to the boundary line marked—no, clear to the line marked E on the extreme right of this map?

A. No, sir, because there is no coal at this property line.

Q. That is because the outcrop does not go to the property line, isn't that correct?

A. That's right.

Q. Actually you are out in the air up here, are you not?

A. Yes.

Q. But did they obtain the right to mine coal all the way to the outcrop?

A. They are mining it. I don't know whether they got [fol. 755] any contract to mine or what was the agreement.

Q. You don't know anything about the agreements between the various parties, do you?

A. No, sir.

Q. I refer you to the line which has been identified as A. After Merritts, Far/West Coal Company, bought out Meadows did they actually mine all the coal to the right of that line to the property line on the top and the outerop on the right?

A. They haven't mined it all yet.

Q. But they are mining it?

A. They are mining it.

Q. Is anyone else mining in there?

A. No, sir.

[fol. 757] Q. Now I refer you to mine number seven which is in the extreme right of the map, and ask you if that is the mine which Mr. Sampey Lester operated.

A. Yes, sir.

Q. And across the top there is a line showing mine number eight. What was that line placed there for?

A. To leave a barrier between the mines.

Q. In other words, Mr. Lester could drive to mine number eight line?

A. If he could.

Q. If he could. There was nothing to prevent him from driving that far!

A. No, sir.

Q. I mark an area on petitioner's exhibit for identification—I mark an area there B, which is between mine number seven and mine number six, and I ask you to state what that area marked B represents?

A. That was to be a barrier between the workings.

[fol. 759] Q. Now we come to mine number five, which is the Standard Smokeless mine, is that right?

A. Yes, sir,

Q. Now I mark an area C and would ask you to tell me what that area C represents.

A. That is to be a barrier. If both mines operate.

Q. Barrier between what mines?

A. That is a proposed mine and number five.

Q. Now I will ask you to tell me what an area marked D [fol. 760] is on Petitioner's Exhibit 81.

A. At that particular time that would have been a barrier, too, if both mines operated equally.

Q. Barrier between which mines?

A. That was number six and five.

Q. Number six was Kyva, is that right?

A. Yes, sir.

Q. And number five was Standard Smokeless!

A. Yes, sir.

Q. Did you know that those mines were owned by the same interest?

A. I knew they were connected. I didn't know their interest.

[fol. 763] Q. What was your purpose of talking to the operators?

A. Well, all I talked to them about what about what

work they needed done.

Q. And if they needed some work they called you?

A. Yes, if they were behind.

Q. And one of your duties was to see if they were mining in accordance with your mining plans, is that right?

A. On projections, yes.

·Q. And you were being paid for inside work by the operators?

A. Yes, sir.

Q. Where did you get your authority to put this barrier.
C at the place that you did on that map?

A. I just put it on there to equalize the amount of coal.

Q. That each operator got?

A. Well, to let him mine there in case the other men

mined up to it.

Q. Mr. Belcher, since I asked you if you had ever dis-[fol. 764] cussed this with me in your office have you had a chance to refresh your recollection?

A. It seems that you were down there.

Q. Did you ever tell me that each operator had a designated area that he was entitled to mine in?

A. Not that I recall.

Q. And that occasionally changes were made, when one miner ceased mining that coal company B obtained advantage or other operators who were mining, that you enlarged their area? Did you ever so state to me?

A. I don't recall, but that is the way we do it.

Q. And also that when a miner, an operator would run into difficulty because of rolls or bad roof conditions that you would enable him to work around the roll?

A. Yes, sir.

Q. And if he could do so in his own area there was no problem, is that right?

A. No, sir.

Q. But if he impinged or intruded on an area that had been laid out to another contractor that it had to be with the consent of the other operator? Did you so state to me?

A., I don't recall.

Q. You wouldn't swear that you didn't so state? A No, sir.

[fol. 769] Redirect examination.

By Mr. Katz:

[fol. 772] The Court: Well, I would like to have it clearly stated by this witness just what did control, if he knows, so that I will know the basis of his answer and whether or not he is qualified to answer this question.

By Mr. Katz:

Q. What did control, Mr. Becher, who would get the coal, for example, where I have marked with a pencil A at the time these three mines started in in the same general direction?

A. The first mine that got to it first.

The Court: Was it a matter of contract, do you know, Mr. Belcher?

. The Witness: No. sir.

Mr. Merrell: What I want to know is the basis for this man's statement.

The Court: Yes, I-would like to know, too. It is a little vague just as to what his authority was and where it was derived from.

Mr. Katz: If your Honor please, as he has already testifield to, this is a planned mining of the entire area of this coal, all of it, and that is because they are all on the Paragon Jewel leases. Now he has testified that these mines are set up in different locations, all driving toward, of [fol. 773] course, the center of the mountain, and he has testified that he doesn't have to pay any attention to any agreements because he is the one that sets up the projections and the barriers and he is the one that changes them as the mines progress into the center of the mountain.

The Court: He might very well project them on a map, but if there is a contract that says to the contrary his projections may not be valid. That is what I want to find

out, as to what the situation was:

Mr. Merrell: There is no showing yet of this man's authority to change them, and he has testified under my cross examination that in these areas I indicated that theman had the right to mine that coal if he could get it.

The Court: Well, of course we have no more foundation

for that statement than we have for these statements.

Mr. Merrell: I agree.

The Court: Let me ask the witness a few questions. Mr. Belcher, on whose authority were you making these mining projections?

The Witness: On my own.

The Court: Well, you didn't own the property. You must have had authority or direction from someone who owned the property, or at least was working the property, to make these projections, didn't you'f

The Witness: Well, all I was told was Mr. Clyborne [fol. 774] told me when he started the mines he didn't want the coal hogged up, and I put the projections on the map.

The Court: Who told you to put the projections on the

map?

The Witness: No one.

The Court: You just acted entirely on your own?

The Witness: That's right.

The Court: Was this a part of your employment?

The Witness: That's right.

The Court: Of employment by whom?
The Witness: I am in business for myself.

The Court: Well, but you were employed by somebody

to make projectinons on these maps, weren't you!

The Witness: That's right, and the state requires you to furnish a map showing a mining system.

The Court: Who was employing you to make these maps

and make these projections?

The Witness: Paragon Jewel Coal Company.

The Court: Then were you acting at their direction when you made these projections?

The Witness: No, sir, they didn't tell me how.

The Court: No, but I mean when you made the maps. I know they didn't tell you how. You have testified they didn't tell you how to project them, but were you acting

at their direction when you took these maps and projected [fol. 775] the various mines?

The Witness: Yes, sir. That is our agreement. I was

to make the maps and furnish them with maps.

The Court: And you were to lay out and project these mines on their property?

The Witness: Yes, sir.

The Court: Now by whom were you paid for doing that?

The Witness: By the contractors.

The Court: For making these projections?

The Witness: Yes, sir.

The Court: Did they tell you how to project them or who did tell you how to project them?

The Witness: No ones Have some difference in the projections depending on the type of equipment that is put in the mine to mine the coal.

The Court: But you say the contractors were paying you

for making these projections?

The Witness: Well, that is part of the engineering in-

side, is laying out the mine and making the maps.

The Court: Were these oral agreements you had with the contractors or did you have any written employment contracts with the contractors?

The Witness: No, just oral.

The Court: Could they tell you which direction to project [fol. 776] the mine?

The Witness: Well, I don't remember of them ever tell

ing me.

The Court: Did you ever have any disputes with any of them as to your projections of their mines?

The Witness: Not that I recall, no.

The Court: Did you ever have occasion to tell a contractor that he couldn't go any further because somebody else was mining that, so that he had to terminate his mining in a particular mine?

The Witness: Yes, sir, when you get close together you

stop them.

The Court: And you had no disagreements with them? They didn't object at all when you said "Well, you have mined as far as you can go"?

The Witness: Not that I recall.

The Court; Did you supply them with other locations

to mine when that happened?

The Witness: Well, they would go back to the management and they would give them another location if they mined that one.

The Court: Now you were asked some questions about whether you testified in another case in a certain manner as to what happened when one operator reached a barrier first. As I recall, the questioning was as to whether or not [fol. 777] you had testified about it, and you said you didn't remember. Can you tell me now what happens if one operator reaches one of the barriers that you laid out first?

The Witness: Well, as a usual thing it depends on how much coal he is producing, and we will change these lines

and give him more coal.

The Court: Who do you work that out with?

The Witness: Well, if it is a very important decision I go back to the management.

Mr. Merrell: I missed that. You go back where?

The Witness: To the management if it is some very serious change.

The Court: Management—who is management? You

mean Paragon?

The Witness: Paragon Jewel Coal.

The Court: Well, supposing it was a serious change, you went back to Paragon Jewel. What happened then?

The Witness: Well, we would work out some system to

change it.

The Court: Then after that system was worked out what did you go?

The Witness: Go back and do the engineering accord-

ingly.

The Court: Did you do this engineering in conjunction with the particular contractor who was operating that area? [fol. 778] Did you discuss it with him?

The Witness: Yes, they know-any time we make a

change they will always know about it.

The Court: Supposing they disagreed with the change?

Did they at any time?

The Witness: Yes, you have some.

The Court: Then what happens if there is a disagreement?

The Witness: They work out something between them.

The Court: Who is "they"?

The Witness: The contractors and the management.

The Court: I think you were also asked some questions about whether you had testified previously about getting the consent of the other contractor if one contractor was going to intrude beyond the barrier on to his area. Did you or did you not attempt to get the consent of the other contractor?

The Witness. There have been some times that they called me in the office and discuss it with me about the change.

The Court: I only want what you know of your own knowledge. Did you enter into any of these discussions?

The Witness: Yes, sir.

The Court: Say contractor A was going to move beyond the barrier between his area and contractor B. Did you [fol. 779] get the consent of contractor B?

The Witness: I don't recall running into that.

The Court: You don't know whether or not it was necessary to get his consent?

The Witness: No, sir.

[fol. 781] By Mr. Katz:

Q. Yes, Mr. Belcher, I asked the question on what did [fol. 782] it depend—what factors did it depend upon as to who would mine the particular coal in the area which we have marked with a pencil A on exhibit 78. In order to refresh your memory as to what we said, I pointed out to you that Bluff Coal Company was driving in the same general direction as the Bare Ridge Coal Company and the Tommy Smokeless Coal Company. All three of them were driving in the same general direction.

Now in the part up here that has no projections on it and nothing else on it which I have marked generally with A, which one of those three could mine, or what would determine which one of those three could mine that coal?

- A. Well, as a usual thing it is the first man that gets back to the coal.
- Q. It depends upon his ability to mine and get to that coal first?

A. Yes, sir.

Q. And if say Bare Ridge gets to A first do you set up barriers as to where Tommy Smokeless Coal Company would go and Bluff City Coal Company would go?

Mr. Merrell: Tobject, your Honor. You ruled that he could answer this. Now I don't think he should be permitted to go further and lead the witness into every little facet of it.

The Court: Well, I think the question was leading, but I will let him answer that one. What we want is what you know, Mr. Belcher.

[fol. 783] By Mr. Katz:

Q. Mr. Belcher, suppose that Bare Ridge got into this A area first that we have marked here. What would happen as to Tommy Smokeless and Bluff City Coal Company? What would you do, if anything?

A. You would leave a barrier between them.

Q. Now throughout the course of the mining from 1951 on up through 1958, and in fact, to the present time, are those barriers always stationary or are they changed?

A. You change them, yes, sir.

[fol. 786] Recross examination.

By Mr. Merrell:

Q. Now you have stated that you made certain projections indicating the coal which the Stillwells would mine?

A. Yes, sir.

Q. And that these projections were changed. Was that [fol. 787] your testimony?

A. Well, there was additions puten and then you change

them when you add other projections.

Q. The changes were to add coal, weren't they, rather than to take it away in the Bare Ridge Coal Company case?

A. Well, in the changed projections you just change a

different direction of driving.

Q. All right, did the result of your change decrease the coal that was available to the Stilwells to mine within the area of your projections at any time?

A. No.

Q. Now let's take Kyva. You testified as to this one change which enabled them to get over into the Sampey Lester mine number seven on Exhibit 77. Now did you ever make any other change of their projections?

A. Not that I recall changing. I have added to them.

Q. Now with reference to Kyva, Standard Smokeless, Far West, Meadows, and Bare Ridge, the changes in projections always resulted in adding coal to the projected area, did it not?

A. I would say it did.

[fol. 794] The Court: Now did any barrier changes that you made ever decrease the area of coal to be mined by any operator who was actually operating at the time? [fol. 795] The Witness: Not that I can recall.

[fol. 797] C. B. Belcher resumed the stand and testified further as follows:

Further redirect examination.

By Mr. Katz:

Q. Mr. Belcher, you have been asked the question concerning the barrier between two mines and the effect that a change of projections and a change of barrier would make on two coal mines that would be operating side by side.

I would draw on a sheet of blank yellow paper here two openings which we will call mine A and another opening

which we will call mine B.

Now assuming that both of these mines were driving in the same direction—that is, toward the letter C which I have marked—in what direction would you make your pro[fol. 798] jections? Would you show how the mine would

A. It goes straight back in the mountain.

Q. All right, and you have now drawn it on B. Now where would the barrier be placed between A and B?

A. Usually it is right straight between them.

Q. Now what is the purpose of this barrier as between mine A and mine B?

A. That is to keep them from cutting together.

Q. Now, Mr. Belcher, for the purposes of this example assume that while mine A has gotten to the point that I have marked with the dotted line, mine B is able to go up to this limit line. Now draw that B as if it were going up to the barrier.

The Court: In dotted lines.

By Mr. Katz:

Q. Draw a dotted line showing its going to the barrier. Now assuming then that B by its mining methods was able to reach this barrier at the same time that A had only gotten up to its dotted lines, what would you do with respect to mine B insofar as the barrier is concerned?

A. I would change it and let the projections extend on

over.

Q. And would then mine B be able to mine across that barrier?

A. Yes, by changing the projections to keep them from

[fol. 799] cutting together.

- Q. In other words, as to A. you would then change the projections of A so it would go parallel with B, is that correct?
 - A. Yes, sir.
- Q. Where would the barrier then be changed between mine A and mine B?
 - A. You would change it between them.
 - Q. Like that?
 - A. Yes, sir.
- Q. And that is the way all of these mines are planned, is that correct?

A. Yes, sir.

Mr. Katz: At this time, your Honor, we would like to introduce this as Petitioner's exhibit—

The Clerk: 82 for identification. Mr. Katz: 82 for identification.

(The document referred to was marked for identification as Petitioner's Exhibit No. 82.)

Mr. Merrell: I would like to object. I would like to have an opportunity to ask him one question.

The Court: All right.

Mr. Merrell: Would you state with reference to the operators that have been mentioned here one situation in which the barrier was changed as you have diagramed it on [fol. 800] that exhibit 82?

The Witness: I don't remember any in those particular

mines.

Mr. Merrell: It has no application to what we are talk-

ing about.

The Court: If it hasn't any application—of course, my question was has the barrier ever decreased the projected area of an operator who was actually operating in that mine B at the time. He said no.

[fol. 804] The Court: Mr. Belcher, have your basic mine maps which show projections so far as you have gone to date over run info a situation just as has been described here and about which you have been asked questions?

The Witness: Yes, we have changed the projections and

then changed the barrier between them.

The Court: In the same manner as you have described on this yellow sheet of paper?

The Witness: Yes, sir, in a similar manner, too.

The Court: Similar manner?

The Witness: Yes, sir.

The Court: Can you tell us in what area this occurred

[fol. 805] or in whose mine?

The Witness: Well, I have changed them in Stilwell's and then in a short mine, a Streets' mine.

The Court: In the Stilwell situation was there anybody operating on the other side of the barrier when you pierced the barrier for Stilwell?

The Witness: Well, the other mines had stopped.

The Court: Well, that is what I mean. There is a little different situation. Have you ever had the situation where two adjacent mines heading in the same direction with the same barrier shown by a line in between them where one simply reaches a barrier before the other and then you pierce the barrier to permit that company to go on through while the other company is still operating?

The Witness: Yes, sir. There is Standard Smokeless Coal Company. We changed that, but it is practically the same situation as I just said. The other mines stopped.

[fol. 806] Further recross examination.

By Mr. Merrell:

Q. I want to ask you one question, Mr. Belcher. I am referring to the operators involved here—that is, the Standard Smokeless, Sally Mining Company, Merritts, Kyva, Far West, and Bare Ridge. Did you ever change the projections so as to cause the coal that they would have mined under the original projections to be decreased?

Mr. Katz: We object to the term "decreased." As we have said, it requires the assumption first that there is a specific boundary or area of coal before you can increase or decrease something. There must be a fixed amount.

Mr. Merrell: You use the word "projected area."

The Court: Yes, I think we ought to understand what the question is directed to. It is simply a projection made on the map. Whether or not that is tantamount to an allo-[fol. 807] cated area or not we are not concerned with right here.

By Mr. Merrell:

Q. Do you understand the question?

A. Not exactly.

Q. I will try and state it again. With reference to the operators that I named, did you ever change your projection so that the coal that they would have mined under the original projections was not to be mined under the new projections? Is that more confusing than the other one?

A. Yes, that's worse.

Q. All right. Now first under your projections there was an area of coal within the projected area, was there not?

A. Yes, sir,

Q. Which if the contractors had followed the projected area they would have obtained, is that correct?

A. Yes, sir.

Q. Now did you ever with reference to the operators I named change the projections in a way that would cause them to lose coal that they would have mined under the original projections before they were changed?

A. No, sir.

[fol. 808] J. L. Worrell was recalled as a witness on behalf of petitioner [Paragon] and, having been previously duly sworn, testified as follows:

[fol. 810]

Cross examination.

By Mr. Merrell:

[fol. 312] Q. Now these tax returns agree with the books of the Paragon Jewel Coal Corporation?

A. Yes, sir.

Q. Did you make an audit of those books?

A. I have never made a complete audit. I have made more or less a test check.

Q. Test check to make sure they agree with the books? [fol. 813] A. That's right.

Q. Now are there any items of expenditure that you know of with reference to the Paragon Jewel properties—I am speaking specifically of the McNeil and Brown tracts—that are not included in the Paragon Jewel books?

A. None that I know of. They are on the return here

some place.

Q. They are all on the return somewhere?

A. Yes, sir.

Q. And are there any items of expenditures that are not deducted either as an expense, as an amortization of mine development, or as a depreciable item?

A. Yes, sir.

Q. What is that?

A. Well, there is federal income taxes, life insurance premiums on the lives of officers not deducted.

Q. Federal income taxes are not deducted and the life insurance premiums on the lives of officers?

A. That's right, for that particular year, 1954.

Q. Can you think of any other items? Can you see any other items?

A. No, no other items in the way of deductions.

Q. Do you know whether Paragon Jewel actually paid any minimum royalty or not on the ground of the McNeil tract?

A. As I recall, they did.

[fol. 814] Q. Wasn't that really a prepayment of it?

A. It is a prepayment, but under the requirements of the lease they prepay it, and I think it has all been recouped.

Q. It was prepaid and then all of it recouped?

A. Either in that year or maybe two years succeeding.

William Culbertson, Jr. was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Gillespie:

[fol. 817] Q. Now did you discuss with Mr. Grogan just what he would expect you to do?

A. Yes, sir.

Q. Just tell the Court what you were to do in the arrangement that you entered into in order to mine that coal.

A. Well, he showed me the place where it was faced up with a bulldozer and told me how much he was paying for the coal, and I just started off and started to work.

Q. Well, what was agreed upon as to who was to furnish

the equipment to mine with?

A. Well, I was to furnish the equipment to mine with. All the mining equipment I had to furnish.

Q. Who was to furnish the labor?

A. I had to furnish the labor.

Q. Who was to provide the compensation and insurance?

A. I had to provide those also.

Q. Now when he took you to this place where the coal had been faced up did he show you how far to the right or to the left you were to mine?

A. No, sir.

Q. Did he tell you how far forward you were to mine?

A. No, sir.

Q. Mr. Culbertson, after you mined this coal what were you to do with it?

[fol. 818] A. The coal had to be delivered to the tipple of Paragon Jewel Coal Company.

Q. And when did you become entitled to compensation for mining this coal?

A. When pay day came after the coal was delivered to their preparation plant,

Q. And how often did those pay days come at that time?

A. Twice a month I think.

Q. Now what did you have to do in order to be entitled to your money?

As Well, I had to deliver the coal to the preparation plant of Paragon Jewel Coal Company.

Q. Was there anything else you had to do?

A. No, sir.

Q. Do you know what Paragon did with the coal or what it was to receive for the coal?

A. No, sir.

Q. Did you know what you were going to receive for each load of coal that you delivered to that tipple?

A. Yes, sir.

Q. Have yoou continued to mine there on that property ever since that time, Mr. Culbertson?

A. Yes, sir.

Q. During that period of time has the price which you have been paid for mining that coal been changed? [fol. 819] A. Yes, it has.

Q. Has that price change ever affected any coal which you had already mined and delivered to the tipple?

A. Well, when the price changed we were notified, any

changes either up or down.

Q. Well, would you be notified before you mined the coal or afterwards?

A. Before we mined the coal.

Q. Did you agree to mine any particular boundary of coal, Mr. Culbertson?

A. No, sir.

Q. What was your agreement as to how long this mining would continue on your part?

A. Well, there wasn't any limitations as far as the period

of, mining.

Q. What was your understanding about how the agreement would be terminated, Mr. Culbertson?

A. Either side could terminate the agreement at any time.

[fol. 821] Cross examination.

By Mr. Merrell:

Q. Are you mining coal for them now?

A. Yes, sir.

Q. Under your present arrangement can they terminate you?

A. Yes, sir.

Q. You have borrowed large sums of money from Paragon Jewel over the years, haven't you?

A. Quite a bit.

Q. Do you actually mine the coal?

A. No, sir.

Q. You subcontract it?

A. Yes.

Q. You take an override in the middle down?

A. Yes.

Q. And your situation isn't the same as the Stilwells, is it?

A. No.

[fol. 822] Q. What do you do?

A. I contract to Paragon Jewel and subcontract.

Q. How many subcontractors do you have?

A. Well, I have had nine at one time.

Q. And what do you get for your services?

A. Well, it is predicated on how much coal you put in, so on and so forth.

Q. You get a tonnage override, is that it?

A. Yes, sir.

[fol. 823] Q. Now you said you always knew what price you would get for a ton of coal when you put it in the tipple. Do you always know what you are going to get for the coal that has not yet been mined by you or by your subcontractors?

A. Well, we know the price that they are paying. If there is any changes made in price structure either up or down we are notified a week previous to that.

Q. So every time you deliver a ton you get a fixed over-ride?

A. Yes, sir.

Q. And if there is any change in price paid by Paragon from period to period that is borne by the contractor, is [fol. 824] that right?

A. That's right.

Q. Either gets the benefit or suffers the disadvantage of a price change?

A. That's right.

Q. Your override is fixed?

A. That's right.

Q. Now isn't it true that you actually contracted for a certain acreage when you dealt with Mr. Grogan?

A. No. There were several acres involved, two or three

different tracts of coal.

Q. There was a specific area, but you don't know how many acres?

A. No, sir, it was a general area.

Q. Did you know the bounds of this general area?

A. No, sir.

Q. Could you have ascertained the bounds of this general area if you had so desired?

A. Well, I didn't know anything about that. That is left up to Paragon Jewel about the maps and engineering. They just gave me a place to put in..

[fol. 825] Q. Now at the time you talked with Mr. Grogan the Paragon operation was getting under way then, was it not?

A. Yes, sir.

Q. And Paragon Jewel was looking for coal that they could sell, weren't they?

[fol. 826] A. Yes, sir.

Q. And did Mr. Grogan encourage you to start this operation?

A. Well, he just took me up there and showed it to me.

Q. Was he desirous that you start the operation?A. Yes, they were anxious to put contractors in.

Q. Did he ask you how much equipment you were able to put into the job?

A. He knew I had a lot of equipment.

Q. He knew you had a lot of equipment?

A. Yes, sir.

Q. And he wanted you to move into the job?

A. Yes, sir.

Q. And get subcontractors to do the work?

A. Yes, sir.

Q. And was one of his methods of encouraging you to tell you that you can move into the job but we want the right to kick you out any time?

A. That was the agreement, the privilege.

Q. I am not asking you what the agreement was. I am asking you what he said.

A. Well, either side had a right to terminate any time

they wanted to.

Q. How do you know either side had the right to terminate any time they wanted to?

[fol. 827] A. Well, when we went in there and took a lease, if you run out of coal or something you could quit, or if they say that your ash is running too high in the coal you could quit. So either side could do what they wanted to.

Q. If you run out of coal you could quit or if you were mining bad coal then you had to either produce merchant-

able coal or quit, isn't that right?

A. Yes, sir.

Q. But as long as the operation was being mined properly and you were producing merchantable coal there was nothing said about quitting, was there?

A. No.

Q. The fact is that when you started on that job you aweren't thinking in terms of quitting, were you?

A. No. I was looking forward to making some money.

Q. Sure. You wouldn't have moved your equipment in there, would you?

A. That's right.

The Court: I assume that you had no written contracts with Paragon Jewel?

The Witness: That's right.

The Court: They were all oral?

The Witness: Yes.

The Court: Did you have any written contracts with any of your subcontractors?

[fol. 828] The Witness: No, sir.

The Court: All right.

By Mr. Merrell:

- Q. Mr. Culbertson, during the years '54, '5, and '6 did you claim percentage depletion on your operation with Paragon Jewel?
 - A. I don't think so.
 - Q. Did you in 1953?
 - A. I might have or might not.
 - Q. You just don't know?
 - A. No, sir, I don't know.
- Q. But as far as you knew there was nothing to prevent you from claiming it, is that right?
 - A. At that time, '52 or '53, I guess that's right.
 - Q. Nobody told you you can't claim it?
 - A. Not at that time.
- Q. It was quite a little later they told you you couldn't claim it, wasn't it?
- A. I think it was after Mr. Woods came to Paragon Jewel, '54, '55.
- Q. While Mr. Grogan was there there was nothing said about it?
 - A. Not when we first started up, that's right.

[fol. 836] Walter Simmons was recalled as a witness on behalf of the petitioners, [Paragon] and, having been previously duly sworn, testified as follows:

[fol. 841] Cross examination.

By Mr. Merrell:

[fol. 843] Q. Did the price that you received for your coal vary during the period?

- A. Yes, sir, up.and down.
- Q. It would go up and down?
- A. Yes. .
- Q. And that was generally in accordance with the changes in market price for coal, was it not?

A. I don't know. In other words—I guess it was. They would come and tell us we have to cut you, or they would raise you. Market picked up I imagine.

Q. When they came and told you they had to cut you

didn't you ask why?

A. Well, I don't know as I did. Being in the coal fields you usually knew when it was up and down.

[fol. 844] Q. Weren't you concerned at the fact that you were getting cut?

were getting cut!

A. Was I—why, sure. Anybody would be concerned, but not much you can do about it I don't think.

Q. You knew from your knowledge of the general market of coal that the price was depressed, didn't you?

A. That's right.

Q. And so you would have to take a cut?

A. That's right.

Q. And then you became elated when they would increase the price of coal?

A. Of course you would feel better when you get more money, if that is what you are driving at...

Q. That was generally in accordance with a general increase in the market price of coal, was it not?

A. Well, I don't know. In other words, I would say that when they got more money for it he come along and give you more. I don't know what they done with it.

Q. You weren't quite as concerned with the reason for the increase as you were the reason for the decrease, I

guess?

A. Well, of course you like to increase, but in the coal fields you usually have to go whichever way it goes I imagine.

Q. When the price in the coal fields goes down everybody [fol. 845] is hurting, aren't they?

A. That's right.

Q. Even a Cadillac dealer?

A. Even a Cadillac dealer.

[fel. 848] Frank H. Woods was called as a witness on behalf of the petitioner [Paragon], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Katz:

Q. Mr. Woods, what is your occupation?

A. I am the treasurer and general manager of Paragon Jewel Coal Company.

Q. How long have you been with the Paragon Jewel Coal

Company?

A. Since February 1, 1952

Q. And at the time you came with Paragon Jewel Coal Company what was your position?

A. Treasurer.

Q. At that time was there a Mr. Grogan also employed by the Paragon Jewel Coal Company?

A. Yes, sir.

Q. What was his full name?

A. L. P. Grogan.

Q. And what was his position?

A. He was the superintendent.

[fol. 849] Q. By superintendent, what did he superintend?

A. He superintended the construction of the roads, power lines, general operation of our processing plant and tipple at Whitewood, Virginia.

Q. Now did you have any other position besides that of treasurer while Mr. Grogan was the general superintendent?

tendent?

A. Well, I assisted Mr. Grogan, ves, sir. I spent two

to three days a week with him.

Q. Now are you familiar with the contracts that were made by Paragon Jewel Coal Company with its various contractors?

A. Yes, sir.

Q. During the time that Mr. Grogan was general superintendent who negotiated these agreements with the miners? A. Mr. Grogan.

[fol. 853] The Court: Well, I think you better limit your testimony to what provisions the company as a policy matter put into their contracts, not necessarily provisions, but what it was the policy of the company to do and what it was to require the contractor to do.

The Witness: That is what I had started to say.

The Court: You were talking about "we told", and I think that is the basis of Mr. Merrell's objection because that would mean you were telling one of these contractors.

The Witness: Oh, I see, yes, sir.

By Mr. Katz:

Q. Well, now explain the policy without-

A. It was the policy of the company to build the roads, to maintain the roads. We built the power lines. We had power available for the contractors if they wanted it. Some of them preferred to put in diesel plants. It was at their option. We didn't force it. We provided engineering service for them, but for that engineering service they were charged five cents a ton.

We paid them—at that time it was every week, but that has changed at different times—for the coal. We never changed the price of coal unless they were notified at least two or three days in advance. Whenever any coal was delivered we wouldn't go back on them and say "the coal [fol. 854] delivered Friday, the price was reduced to 25 cents." They always knew in advance, any increase or reduction in the price of coal.

They were told that they could bring their equipment in there, any time they wanted to they could leave, any time that we wanted to move you out we can tell you to leave.

They were told that on the equipment, all their equipment they brought in they could take their depreciation on all that. On the coal we claimed depletion.

The question came up why don't we get this. I said "we own the coal in place. You are only in here mining it for us. In other words, we are paying you for mining our coal."

[fol. 857] By Mr. Katz:

Q. I will ask you, Mr. Woods, what was the policy of the company with respect to the delivery of the coal from the mines of the independent contractors to the tipple of Paragon Jewel. What was your policy with respect to the delivery of that coal?

A. We required all of the coal to be delivered to our

[fol. 858] tipple.

Q. Now at the time that this coal was delivered when did the contractors become entitled to receive their compensation for mining that coal?

A. As soon as the coal was weighed on our scales and

dumped into our bins.

Q. Were the contractors required to take any loss in the event that Paragon Jewel Coal Company sold this coal at a loss?

A. No, sir, the contractors never knew what we received for our coal.

Q. As a matter of fact, Mr. Woods, would it even be possible for the contractors to know what price or what amount that Paragon Jewel received for the coal?

Mr. Merrell: I object. I think it would be possible.

Mr. Katz: Well, we want to see. Let him answer and then we will see. In other words, the coal is not in the same form when it is sold, your Honor.

The Court: What is the ground for your objection?

Mr. Merrell: I will withdraw it.

The Court: You may answer the question.

The Witness: It would be possible for them to know, but we never advised them. They may have various means to find it out from someone we were selling coal to or something like that, but we never discussed our prices with [fol. 859] them.

By Mr. Katz:

Q. Is the coal, Mr. Woods, that the contractors delivered to your tipple in the same form when it leaves your tipple as it was when it came to the tipple?

A. No, sir.

Q. Well, what happens at the tipple to that coal?

A. The raw coal or run of mine coal, we speak of it, as it comes out of the mine is dumped into the tipple, through a series of separations and washings, sizing and grading, oil treating. When it comes out there are four different grades of coal. It goes in, it is all mingled together. A lot of times there are rock, impurities, sticks, stone, pieces of steel wire and everything in there. That is removed before the coal is loaded in the railroad car.

Q. Do all four of those qualities or sizes of coal receive the same price on the commercial market that you sell to?

A. No, sir,

Q. Who did the contractors look to for the payment of their compensation for mining of that coal?

A. They looked to Paragon Jewel Coal Company.

Q. And did they ever look to anyone else?

A. Not that I know of, no, sir.

Q. How often does the price on the commercial market [fol. 860] change in respect to coal, Mr. Woods?

A. Every day.

Q. In other words, it changes all the time?

A. Yes, sir.

The Court: Does Paragon Jewel sell any of its coal under contract?

The Witness: Sir, I really couldn't answer that. John McCall Coal Company is—they sell the coal for us. I am not too familiar with the details of the sales of it. I know the prices we receive.

The Court: You don't have any fixed contract price for

the sale, do you?

The Witness: No, sir.

By Mr. Katz:

Q. Mr. Woods, there has been introduced in evidence petitioner's exhibit number 74, which shows that the amount per ton paid by Paragon Jewel to Bare Ridge Coal Company from November of '51 to September 30, 1957 changed nine times in six years. I will ask you whether or not the price per ton of coal that Paragon Jewel sells on the commercial market has changes more or less often than that.

A. Roughly I would say it probably had changed 900 times. We had three or four price changes in one day. In other words, your price range may vary as much as 35 or 40 cents on one grade of coal in a day, and sometimes four [fol. 861] grades of coal, why, there is no limitation to

what you—

Q. I will ask you then whether or not the changes in the amounts paid to the contractors are directly connected with the price which you receive per ton on the commercial market.

A. Not directly, no, sir.

Q. Now did you ever make any contracts or discuss any agreements with the Merritts?

A. No, Mr. Grogan negotiated the agreement with the Merritts.

Q. Now at the time that the Merritts bought out the Meadows mine did you have any discussions with them?

A. Well, at that time they had been on our property so long that we didn't go into the details of all of the agreement because they started there in 1953. We did, how-[fol. 862] ever, approve the transfer of the Meadows leaving and the Merritt boys moving in.

Q. Well, will you please explain to the Court what happened with respect to the Merritt-Meadows transaction?

A. Yes, sir.

Mr. Merrell: He can testify as to things he has firsthand knowledge of.

By Mr. Katz:

Q. Yes, the things you know personally.

A. Sherman Meadows, the operator of Meadows Coal Company, came to see me, said he had an opportunity

to go in business over at Swords Creek, Virginia, that he thought he could do better than he was doing on our property, that if I find someone who will buy my equipment outside is it all right with you if I sell out. I said "Sherman, if you trade with someone who we approve of that is perfectly all right."

Well, on one Sunday afternoon I would say between 3 and 4 o'clock, I believe it was, Mr. Lee Merritt called me and said he had been talking to Sherman and they had tentatively arrived at an agreement to take over his opera-

tion.

Q. What was the name of the operation?

A. The name of the operation was Meadows Coal Company.

Q. And what year was that?

A. That was in 1956, I think the first part of November. [fol. 863] Q. All right, sir.

A. And asked me, said "before we close this up will you let us mine the coal?" I says "Lee, you go ahead and close your transaction. As far as I am concerned you can mine the coal, but I would like to see you the next time I come down to the mine."

Well, I don't know whether it was Wednesday, Tuesday, but the next trip that was down there he came to see me and said that he had closed the transaction. That was the extent of it.

Q. Now is that, then, all that took place between you and Mr. Merritt and Mr. Meadows with respect to this transaction?

A. Yes, sir, that is about all.

[fol. 869] Q. Well, will you please explain to the Court whether or not these men had any particular area of coal which they could mine?

A. No, sir, they did not.

Q. Well, explain how they were to proceed with the mining of the coal?

A. They were to proceed with the mining of the coalthe way we projected the mines. I say we—the engineer, the coordination of the engineer and the company, depen-[fol. 870] dent on their ability, how much equipment that they had, what the conditions were inside, they mined in whichever direction we wanted them to mine in. As they got in we would give them a little bit more area, a little more territory. They could have 6 working places, 10, 12. When they start you never know whether a man is going to be say—we classify them as the major leaguer or minor, whether he is going to be a minor leaguer or major leaguer. These boys are all major leaguers.

Q. Well, by a major leaguer then what were they able

to do that a so-called minor leaguer couldn't do?

A. Well, they knew a lot more about coal mining than some of them we had. Some of these boys came with us may have been employed somewhere else. That was their first experience, adventure in that kind of business, and they found out it wasn't as easy to do as they thought it was. They stayed a few weeks or months and left.

[fol. 882] Q. Now what is the purpose of Paragon Jewel in setting up the mining system as you have just testified to? What is the reason for that method of setting up the system?

A. Well, the reason for setting up the system is we want to get all the coal we can get out of the leases that we have. On some of our leases we are required to recover 85 percent of the merchantable amount of coal or we pay royalty for it if we don't mine it, and with careless operation if you just turn some of them loose in there and let them go in where they want to you would have hundreds and hundreds of thousands of coal that would be messed up that you couldn't recover.

Q. And if you couldn't recover that so called messed up coal what would happen with respect to Paragon Jewel and its obligation under its leases?

A. We would pay royalty on coal that we never were able to mine.

Q. What is the amount of coal, percentage of coal that you have to mine from these leases, Mr. Woods?

A. Well, on the Brown number one lease at least 85 percent, and I am not positive—I would have to look at the McNeil lease to see what the exact percentage is.

[fol. 885] Q. Mr. Woods, has Paragon Jewel ever had to shut down its tipple?

A. Yes, sir.

Q. Will you please explain the reason for it?

A. Well, the reasons, sometimes we couldn't get railroad cars, repairs, something took a day or two to complete, or lack of business.

What is the longest time that you have ever had to keep the tipple shut down?

A. At any one special time I think a week is the longest.

Q. Now during the time that your tipple is shut down what do the miners do?

A. Well, they either don't work or some of them—they will work and run enough coal to fill up their storage fa[fol. 886] cilities, the cars, bins, and so forth, or they don't do anything.

Q. Now even though Paragon Jewel is unable to take the coal at their tipple can these contract miners sell that coal to anyone else?

A. No, sir.

Mr. Merrell: I would like to move to strike that. There is a point here, actually whether these contractors can take the coal elsewhere has never arisen. Paragon Jewel has always agreed it has taken all the coal that they can produce,

The Court: Getting into whether or not they have the right to do it, whether a particular contractor has a right to do it, I don't believe he is qualified to testify except those he negotiated.

By Mr. Katz:

Q. Let me ask you this. When your tipple was shut down, as you have testified, for a week, did any of these contract miners take that coal to any other tipples and dispose of it?

A. No. sir.

Q. What did they do with respect to their own mines?

A. Well, they would maybe do some repair work or some outside work if something had to be done. They could mine

enough coal to fill up what storage capacity they had until [fol. 887] the tipple resumed operation:

Q. What do you mean by storage capacity?

A. Well, their chutes. Most of these mines, on the outside they have chutes. They have their mine cars. They could have all their mine cars loaded, their chutes loaded and their trucks loaded, and the minute the tipple went back into operation they could dump that coal in there, more than we could take for an hour or two to get caught up.

[fol. 889] Cross examination.

By Mr. Merrell:

Q. Did Paragon Jewel always take all the merchantable coal that the operators produced?

A. As far as I know, yes, sir.

- Q. You said there was nothing secret about these maps, if the operators asked for one you would give them one?
- A. Yes, we give it to them twice a year anyway. We have to.
 - Q. You are obligated to?

A. Right.

Q. And there is an obligation to have a mine map at the mine operation, is there not?

A. All the time, yes.

Q. That is required by state law?

A. Right.

Q. I believe you also said that at first the outerop coal is not regarded as merchantable coal, is it?

A. Well, it isn't-outeron coal is not.

Q. You have to get ba n until you get to the good coal!

A. Right. Maybe sometimes 25 feet.

- Q. And you have to develop some places so you can work, so you can get a respectable tonnage, do you not?

 [fol. 890] A. Right.
- Q. Now you mentioned that you would take these menup and they would look at the coal as it was faced up.

A. They would see the coal as it was faced up before they started spending any money.

Q. So they could tell whether they could make any money

there or not, wasn't that your answer?

A. They would think so, yes, sir.

Q. Of course they wouldn't know whether they could make any money until they got back in the good coal?

A. No, they knew everybody around them was making

some.

Q. But they don't know where the rolls were?

A. No, nobody knows what is under the mountain until you get there.

Q. A vein can change quickly?

A. That's right.

Q. So they wouldn't know until they got in operation whether they could make money or not?

A. Well, they wouldn't be sure.

Q. And in order to produce coal they have to bring their equipment in there, don't they?

A. Yes, sir.

Q. And they have to have a tipple or what you call a chute?

[fol. 891] A. Chute.

Q. To take care of the coal when they bring it out. And if they mine on rails, as the Stilwells did, they have to lay their rails into the mine?

A. Right.

Q. And they have to arrange for their power, do they not?

A. They take the power inside the mine, yes, sir.

Q. Even when you furnish them power they have to convert it from AC current to DC current, do they not?

A. Right.

Q. And set up a substation to do that?

A. Yes, sir.

Q. They also have to watch the roof as they move back in?

A. Yes, sir.

Q. That is why they leave these pillars, is it not?

A. Yes, sir.

Q. And when they pull pillars actually they are pulling back from an area where they have previously mined?

A. That's right.

Q. And they really don't know until they have got themselves established on the property and gotten into the mine a certain distance whether they are going to make any money or not, do they?

[fol. 892] A. They don't know, but they have a general

idea.

Q. They hope they will, or they wouldn't start!

A. That's right.

Q. But they don't know. And when you came with Paragon Jewel—I believe it was in February, 1952?

A. Yes, sir.

Q. Paragon Jewel was hurting for coal, wasn't it?

A. Well, we weren't hurting for coal. We were trying to get their production built up.

Q. Well, if you didn't produce it you had to pay your minimum royalty?

A. That's right.

Q. You had this big processing plant that somebody had to pay for, didn't you?

A. Yes, sir.

Q* And you were planning to pay for it out of the coal that was mined from the property?

A. Yes; sir.

Q. And you did, in fact, encourage these miners to make the investment and develop the mine, did you not?

A. Yes, sir, we even advertised for them sometimes.

Q. And one of your main policies was to advise them, as I understand your testimony, that regardless of their situation in that mine you reserved the right to terminate them at any time?

[fol. 893] A. Yes, sir.

Q. That was definite!

A. Yes, sir.

Q. And you made that known to every contractor that you entered into agreement with?

A. I made it known to every one I have entered into agreement with, yes, sir.

Q. Did you make that known to the Sally Mining Company?

A. Yes, sir.

Q. And who did you tell it to?

A. Mr. Lloyd Conley.

Q. And when did you tell it to him?

A. I told it to him on a trip I went with him to look inside the mine. Before he ever acquired that mine he went inside to see what the conditions were. He says "I don't know whether I am going to be able to mine in here or not." Said "this looks pretty bad." I said "Lloyd, if you can't mine it you can quit any time you want to, and at the same time we can run you off any time we want to."

Q. And you knew he was investing in the equipment?

A. Yes, sir.

- Q. But when the Merritt brothers bought out the Meadows mine you made no such statement?
- A. No, sir. Conley was a new man. He had never operated on our property before. The Merritt boys had been [fol. 894] there four, nearly five years when they bought out the Meadows.
 - Q. They had only been there a matter of two years.
- A. Well, they started in '53. That was '56. Well, two, three years.
- Q. The first thing you said was "we want to make it certain we can terminate your arrangement"?

A. Yes, sir.

Q. And also you made it certain that you were to have the depletion?

A. Yes, sir, depletion was discussed.

Q. And you did that with Belcher?

A. I think I did, yes, sir. Q. But you are not sure?

- A. I did that with the mines that Belcher had on our property before Mr. Grogan left us. Well, that would have been all of them because he didn't have any up to that time.
 - Q. Now who has to obtain the mining permit?

A. The operator. The contractor.

Q. Who is responsible to the state mining authorities?

A. Responsible for what?

Q. The proper operation of the mine.

A. The mine foreman and the owners of the mine.

Q. That is the operators of the mine?

A. Yes, sir.

[fol. 895] Q. And if anything is wrong in their mine they go to the state authorities, go to them, do they not?

A. Yes, sir, they go to them first.

Q. When the Merritt brothers bought out the Meadows mine and you were discussing it with them do you recall telling them that they had the largest single block of coal that Paragon Jewel had left on its property?

A. No, sir.

Q. Do you recall later after they bought it out in November, 1956, as I recall your testimony; and right after the first of the year a map was issued to them and this map did not accord with their understanding of the area that Mr. Meadows had, do you recall their raising the question with you?

A. I can't recall that specific instance. I know there have been a lot of disagreements as to take 30, 40 people on the job. I can't remember—

Q. You can't recall their coming to you and saying "we understood from Mr. Meadows that we had a larger territory than is shown on this map"?

A. No, they saw Mr. Meadows' map. They saw what his

map was before they ever brought it over.

Q. How do you know that?

A. They were right next door to him.

Q. How do you know they saw it?

[fol. 896] A. I would certainly think before they put out any money they would see that. He told me they had agreed.

Q. They should have known from Mr. Meadows' map what they were acquiring, shouldn't they?

A. I would think so. I don't know.

- Q. They thought they did. But the map after the first of the year was different than the map they saw from Mr. Meadows. That is why they raised the question, as I understand.
 - A. I really don't know, sir.

Q. You don't recall anything about it?

A. I really don't know, sir.

Q. But you are not saying under oath that it did not happen?

A. No, I am not saying it did not happen. I am not saying it did happen. I say I do not remember the par-

ticular instance you are speaking of:

Q. Now you said that when the operators delivered a ton of coal to your tipple they had a right to be paid, is that correct?

A. State that again.

Q. When the contractors delivered a ton of coal to your tipple they had a right to be paid?

A. Right.

- Q. Did they have a right to be paid anything before they delivered a ton of coal to your tipple?

 [fol. 897] A. No.
- Q. The price was based on the coal being put in your tipple?

A. Right.

Q. And they knew at that time what they would get for the ton of coal they were putting in your tipple?

A. Right.

Q. Did they know at that time what they would get for the ton of coal they would put in your tipple next week?

A: They knew that the price stayed the same until they were given notice. In other words, we gave them notice at least two to three days ahead, so they knew that—let me—

Q. Excuse me.

A. Let me state it this way. They always knew the price they would receive for the coal when they delivered it to our plant.

Q. Now would you answer my question, Mr. Woods, which was did they know what they would receive for the coal which they would deliver to your tipple two weeks from that day?

A. I don't understand you. Let me ask you this.

Q. No, I am asking the questions. You don't understand it?

A. No, sir, not yet.

The Court: Talking about unmined coal.

[fol. 898] By Mr. Merrell:

Q. Unmined coal. Did they know what they would receive for unmined coal?

A. No. No, they didn't.

Q. Now when the Merritts first started they were paid a lesser price for the coal that they produced than the

other contractors, is that not right?

A. I believe for a week or two they were shooting coal on the solid before it was machine cut. All the contractors got a lesser price than they did after they got their machines.

Q. Why do you pay them less for solid shot coal?

A. Solid shot coal, you couldn't get any lump coal in it. It breaks it up like a—

Q. It makes it less desirable from a marketing standpoint?

A. Yes.

[fol. 903] By Mr. Merrell:

Q. How can one of your operators become a productive miner unless he is assured a security in his operations? That is the right to mine for a period of time.

A. He has a right to mine for a period of time unless he does something that is against the way we want the coal mined, unless he decides he wants to take off himself.

Q. You mean if he mines properly and produces coal and complies with the regulations, state and federal, does a good job, that he has a right to stay there?

A. He has a right to stay there, yes.

Q. And mine the coal?

A. And mine the coal.

[fol. 904] Q. Now there has been some discussion regarding this wheelage across the White tract, and when Sally Mining Company went in there were they required to pay wheelage!

A. Yes, sir.

Q. Five cents a ton!

A. Yes, sir.

Q. Did they have an alternative of using a road?

A. At that time I don't know whether they had that alternative or not. The road was there but we would have had to do some work on it for them to have go ten across.

Q. The road was impassable, was it not?

A. I would say it was at that time, yes, sir.

- Q. You had taken a number of culverts out, had you not? [fol. 905] A. Well, I don't know just exactly everything was done, but I would say the road was not in a condition to haul over.
- Q. The deal was put to the Sally Mining Company on the basis of five cents a ton wheelage without any alternative, isn't that right?

A. That's right. He knew that before he started, yes,

sir.

Q. He knew he would have to pay five cents for wheelage before he started?

A. Yes, sir.

[fol. 908] Q. Does Paragon Jewel have an exclusive contract with the John McCall Company to handle their coal?

A. Yes, sir.

Q. They sell all your coal?

A. Yes, sir.

Q. What do they do at that time-

A. Sold to them f.o.b. tipple.

Q. The contractors bring it in, you process it, dump it into railroad cars, and John McCall takes it from there?

A. Right.,

Q. On this conference you referred to about six months ago when the Stilwells and the Merritts and you and your engineer got together you said they could hear each other blasting, is that right?

A. Yes, sir.

Q. These engineering projections are not always completely accurate, are they?

A. No, sir. There is always a possibility that there might be a mistake there. I don't say the maps are a hundred percent accurate. In fact, they have proven to be wrong on occasion.

Q. Occasionally a man might run into a mine when he thinks he is a distance away from it?

A. Yes, sir.

Q. And it was your testimony you discussed this for a [fol. 909] matter of a half hour and reached an agreement as to who—

A. Something like that, yes, sir. I don't remember exactly.

Q. And an agreement was reached by the parties thereto

as to who would mine the coal, is that right?

A. Yes, sir. And a year and a half ago we had another one that said we would wait until things get a little closer and then we will check again. So this last meeting was a result of that, and I think Mr. Merritt started pulling the pillars right after that.

Redirect examination.

By Mr. Katz:

Q. Mr. Woods, Mr. Merrell has asked you whether or not the contractors aren't taking a big risk in investing their money in this equipment without knowing whether or not they are going to make any money in mining. I will ask you whether or not Paragon Jewel Coal Company with its investment in its tipple can make any money if the miners can't get the coal out.

A. No, sir.

Q. Can you make any money then if the miners can't get the coal out?

A. No. sir.

[fol. 910] Q. Mr. Merrell has also asked you whether or not the contractors knew the price they would get for unmined coal. Were any contractors at any time required to mine unmined coal if they did not want to?

A. No, sir.

[fol. 917] C.-W. Stilwell was called as a witness on behalf of petitioner [Merritt], and, having been first duly sworn, testified as follows:

The Clerk: Will you state your name and address for [fol. 918] the record?

The Witness: C. W. Stilwell, Rayen, Virginia,

Direct examination.

By Mr. Merrell:

- Q. State your occupation.
 - A. Coal miner.
 - Q. What kind of mining do you do?
 - A. We operate a coal truck mine.
 - Q. Is that strip or underground mining?
 - A. Underground.
 - Q. How long have you been engaged in coal mining?
 A. About 26 years I have operated the mine.
 - Q. When was the Bare Ridge Coal Company organized?
 - A. In '46.
 - Q. Is it a partnership?
 - A. Yes, sir.
- Q. Who is the other partner?
- A. That is my brother, S. W. Stilwell.
- Q. What is the interest of each of you? A. 50-50.
- Q. What was the first job of Bare Ridge Coal Company?
- A. Consumer's Mining Corporation.
- Qo What did you do for them?
- A. We mined coal the same way we are now.
- Q. Did you mine that job out?
- [fol. 919] A. Yes, sir, we did.
 - Q. What was the second job?
 - A. Laurel Fork Coal Company.
- Q. When did you start the Laurel Fork Coal Company job?
 - . A. We started in '48.
 - Q. And did you work that job out?
 - A. Yes, sir, we did.

Q. Are you mining coal at the present time?

A. Yes, sir.

Q. On whose lease are you mining coal?

A. Paragon Jewell Coal Corporation.

Q. How long have you mined coal on the property covered by their lease?

A. It will be 10 years this month.

Q. That would be since sometime in 1951?

A. '51.

Q. Are you mining under a written agreement?

A. No, sir.

Q. What kind of an agreement?

A. Just an oral agreement:

Q. Have you operated continuously since 1951?

A. Yes, sir.

Q. Have you ever had any dispute with Paragon Jewell, regarding the agreement?

[fol. 920] A. No. sir.

Q. Who did you negotiate the agreement with?

A. L. P. Grogan. .

Q. Whom did Mr. Grogan represent?

A. He was representing Paragon Jewell Coal Corporation.

Q. What was his position with that company, if you know?

A. I understood he was superintendent.

Q. When did you first commence discussing an agreement with Mr. Grogan?

A. Somewhere around July or August in '51.

Q. At that time, did you examine the properties of Paragon Jewell?

A. Yes, sir, we did.

Q. Were there any other operations on the property at that time?

A. No, sir, there wasn't.

Q. Was this on the McNeil tract?

A. Yes, sir, it was.

Q. Tell us what you discussed and what happened when you negotiated with Mr. Grogan.

A. Well, when we contacted Mr. Grogan for our lease, we went to see him and talk to him about the job and he

told us he had to make coal under lease and showed us on [fol. 921] the map the boundary that would be three operations put in that we could have our choice out of either one. He had one of these mines faced up, we went and looked at it and we didn't like it, we didn't think it was a suitable place to mine. We went around in the woods, but so far from it, and located a place what we thought would be a place for good mines and we took a place there on the middle one, we took the middle job.

Q. Was the mine faced up at that time?

A. No, sir, it wasn't.

Q. What did Mr. Grogan tell you with reference to the area of coal involved in the mine that you were taking?

A. Well, he showed us on the map the boundary and he showed us how far back the boundary ran to the McNeil tract, between McNeil's heirs and Brown heirs, and he laid his hands down on the map and said we could go so far to the right and so far to the left, all the way back to the McNeil tract.

Q. Did he indicate to you how far you could go on the right?

A. Yes, sir, he did.

Q. And on the left?

A. Yes, sir.

Q. Was the map submitted to you at that time?

A. Nothing but the boundary lines on the McNeil lease. [fol. 922] Q. And after you negotiated with Mr. Grogan, did you commence operations?

A. Yes, sir, after we negotiated with him, and leased the boundary, we started in to open up the mines, set up, built us a tipple, got ready to run coal, and cut under the roof enough to set spads, then Mr. Belcher he come and set us up a map to drive by.

Q. Did this map that Mr. Belcher submitted to you show the boundary of coal that Mr. Grogan had indicated?

A. Yes, sir, it did.

Q. I show you Petitioner's Exhibit for identification Number 80 and ask you if you would identify that? State what it is.

A. Yes, sir, this one right here (indicating)

Q. (Interposing) No, state what the map is first.

A. Oh, the map, this is the boundary of the part of the McNeil tract of coal, up to this line here (indicating).

Q. Was this map given to you?

A. Mr. Belcher was the one that gave me this map, after we set the mine up.

Q. Mr. Belcher who does the engineering work?

A. Yes, sir.

Mr. Merrelt: I would like to offer in evidence now, Petitioner's Exhibit 80, as the map that was given to Mr. Stilwell [fol. 923] at the time he commenced operations on Paragon Jewell property.

The Court: Any objections?
Mr. Katz: No objections.

The Court: Petitioner's Exhibit 80 will be received in evidence.

(The document previously marked for identification as Petitioner's Exhibit 80 was received in evidence.)

By Mr. Merrell:

Q. On Exhibit 80, I am marking a line with the letter "A" in red pencil. Will you tell me what that line represents?

A. That was the boundary line between us and the next tract of coal over here that was laid off for Mr. Henegar of Bliff Coal Company.

Q. Now, I next mark a line "B" and ask if you would

tell me what that line represents?

A. Well, that was as far as we could go to the left, on account he was putting another operation on this side, to drive around a small tract of coal here, and he showed us on the map that we could come over that far and stop, drive up to the lease line.

The Court: By "this side", you mean to the left?

The Witness: That was to the left of our operation here.

[fol. 924] By Mr. Merrell:

Q. I make a mark "C", and ask you to identify it?

A. Line between the McNeil and Brown heirs.

Q. You have indicated an area there which is enclosed by lines identified as "A", "B" and "C"?

A. Yes, sir.

Q. Were any representations made to you regarding that area by Paragon Jewell Coal Company at the time you started operations?

A. How is that now?

Mr. Merrell: Will you read that back?

(The reporter read the record as requested.)

The Witness: No, sir.

By Mr. Merrell:

Q. Who was entitled to mine the coal within the area. enclosed by lines "A", "B", and "C"?

A. We was.

Q. What were the terms of the agreement you negotiated with Mr. Grogan with reference to the disposition of the coal after it was produced by you?

A. Mr. Grogan was to handle all the coal that we could

mine.

Q. By Mr. Grogan, you mean Paragon Jewell Company?

A. Yes, sir.

Q. Where was it to be delivered? [fol. 925] A. At their tipple:

Q. At whose expense?
A. At our own expense.

Q. Who was to haul the coal?

A. We were.

Q. How far is it from your mine tipple to the Paragon Jewell tipple?

A. I would say a little over half a mile.

Q. During the course of your operations on Paragon Jewell property, had they taken all the coal that you had produced?

A. Yes, sir, they had.

Q. Have they ever refused any coal?

A. No, sir, they haven't.

Q. What were the terms of the agreement with reference to the building and maintenance of the roads of access to your property!

A. Mr. Grogan was to build a road up by our mines and

keep it up.

- Q. Was to build a road up to your mines and maintain it?
- A. The road went on by us at that time and he was to maintain the mine road.
 - Q. How far was that road from your tipple?

A. Run right by our tipple, at the bottom.

[fol. 926] Q. How far from your mine entry?

A. About 200 feet.

- Q. Who was to build the road from the Paragon Jewell road to your mine?
- . A. We built that ourselves.

Q. How did you build it?

A. We got a dozer and started work on it to open up the mines, build the work, small dozer, he worked 33 hours and one-half on it and he decided his machine was too small for the job and he advised me if I could, to get the company dozers and their shovels to finish it up.

Q. By "company dozers" you mean Paragon Jewell?

A. Yes, sir.

Q. Did you do that?

A. We contacted Mr. Grogan and he let his shovel and dozer finish up the job for us and we paid him for it.

Q. You-paid Paragon Jewell?

A. Yes, sir, we did.

Q. What were the terms of agreement with reference to the price or amount that you were to receive for coal that you produced?

A. We was to get \$4 a ton when we started out and Mr. Grogan told us that the price would be ruled by the market. If the market went up, we would get an increase. If the market went down, we would have to take a cut on the [fol. 927] price of coal?

Q. Now, when you were negotiating this agreement, what was said between you and Mr. Grogan, if anything, as to the right to terminate the agreement?

A. There was never nothing said about that at all.

Q. What was said with reference to your right to mine the coal from within the area covered by your agreement?

A. Well, we was to mine all mineable coal that was under the tract, down there where we leased:

[fol. 928] Q: Did you expect to be there more than three years?

A. Yes, we did, we expected to be there more than that.

Q. At that time, did you and your partner make any plans as to the tonnage which you hoped to build up to?

A. Yes, sir, we did.

Q. What was that?

A. We had our plans to try to get up to 300 ton a day.

Q. Why did you want to get up to 300 ton a day?

A. We figured it would run that much to make any money.

Q. Would you state what you did after you obtained this agreement from the Paragon Jewell to get into operation?

A. Well, we had to build us a tipple, after we got that built, lay a track to the mines, we had to buy machines, power plant, mine cars, and a motor to operate with, and then get men enough to operate it.

Q. How long between the time you went into the property

was it before you commenced running coal?

A. Well, I would say somewhere from six weeks to two months, I don't remember just exactly.

Q. Did you—what did you do for power?

[fol. 929] A. We bought us a power plant, we bought a Cummings diesel engine with 100 KW generator.

Q. Did you buy any power from Paragon Jewell?

A. Yes, sir. we did. /

Q. What was that for?

A. To run a fan

Q. Was that a-what kind of fan was that?

A. That was a mine fan, a small mine fan.

Q. What was the agreement between your partnership and Mr. Grogan and with reference to the engineering services inside the mine?

A. Well, we was to pay for the engineering by the ton.

Q. Did this engineer do the inside work?

A. Yes, sir, he did.

Q. How often does he inspect your operations?

A. Well, most of the time when we call him.

Q. How were the payments made to the engineer?

A. Deducted from pay slips by the ton.

Q. Aside from the road to the Paragon Jewell road that ran within two-hundred feet of your mine, is there anything else that Paragon Jewell Coal Corporation has provided for your operation since the commencement?

A. No, sir, they haven't.

Q. Did you have any understanding with Mr. Grogan as [fol. 930] to what you could do with your equipment and

buildings when the job was completed?

A. The only thing that was said about that, Mr. Grogan told us it was strictly understood with the landlord that we could not take no buildings down when we got through mining, that was the only thing said about that.

Q. At the present time, Mr. Stilwell, how deep is your

mine, how far have you driven back?

A. Well, I would say somewhere around 8,000 feet.

Q. Now, tell us how many mine entries and air courses you have in your mine?

A. We have one mine entry and two air courses and several cross-sections.

Q. What is a cross-section?

A. That is a section turned off your mine entry.

Q. What are—what is the purpose of these air crosses?

A. That is to ventilate the mine.

Q. During the course of your operations, have you ever run into any adverse mining conditions?

A. Yes, sir, we have.

Q. What type of conditions are regarded as adverse in the coal mining operations?

A. We have run into water, we have had to pump it out, and then we run into rolls where the coal squeezes out

[fol. 931] and then you have to shoot through the top to get through.

Q. As you mine coal, what are your problems with refer-

ence to the maintenance of the roofing of the mine?

A. Well, you have to keep it well timbered, all loose rock taken down, you have to keep all loose coal cleaned up under the mine lines, and rock dust as well in all working places.

Q. Have you run into these rolls frequently during your

operations?

A. Yes, sir, we have.

Q. What do you do when you run into one of these rolls?

A. Have to start drilling and shooting through the top to go through, to make it high enough to get your equipment through if there is any coal on the other side.

Q. When you are shooting the roll, how much coal are

you producing?

A. Not any.

Q. Why is that?

A. The coal is all squeezed out, nothing but rock.

Q. Did Paragon Jewell Corporation ever pay you anything for adverse mining conditions?

A. Yes, sir, one time.

Q. Would you state when that was?

- A. I believe that was in '55, we went into what we call a sandstone roll and we was having it kind of tough, we [fol. 932] went to Mr. Woods, and tried to get more on the ton for the coal to help us out to get through it, and he wouldn't give us anything on the ton, but he agreed, if we could figure up the cost of going through the roll, he would go 50-50 with us on it.
 - Q. Did he do that?

A. Yes, sir, he did.

Q. Where was the location of that particular roll?

A. That was right close to the Brown heirs, right next to McNeil tract.

Q. Mr. Woods indicate to you the reason he was desirous, why Paragon Jewell wanted you to get through this roll?

A. Yes, sir, we was trying to get through this roll going on into Brown heir tract coal.

Q. At that time, had they made any representation to you

regarding your right to mine on the Brown property?

A. Yes, sir, I believe they told us that we could go on through when we got to it, that they leased the coal and we could drive on across.

[fol. 933] By Mr. Merrell:

- Q. What control, if any, does Paragon Jewell have over your mine?
 - A. Not any.
 - Q. Who pays the taxes on your equipment?
 - A. We do.
 - Q. Who pays the liability insurance?
 - A. We do.
- Q. Did-have you ever borrowed any money from Paragon Jewell?
 - A. No. sir.
 - Q. Did you ever borrow any equipment?
 - A. No, sir, we haven't.
- Q. Who obtained the mining permits from the State authorities?

[fol. 934] A. We did.

- Q. Who is responsible to the State and Federal Mining?
- A. We are.
- Q. Do they call at your mine?
- A. Yes, sir.

By Mr. Merrell:

- · Q. Do they inspect your mine?
 - A. Yes, sir.

[fol. 935] Q. What supervision does Paragon Jewell exercise over your mining operation?

A. Not any, except the engineers sets the spads for us to go by.

- Q. Who pays this engineer?
- A. We do.
- Q. Now the records show that you started mining coal at \$4 per ton, and on February 2, it was increased to \$4.50 per ton. Do you know, what caused the increase?

A. Yes, sir, I do.

Q. Would you explain that?

A. We started out at \$4 a ton, and we decided we weren't going to be able to make it, and we made arrangement with Mr. Grogan to have a meeting with Mr. Clyborne and we all met at Richlands one night and talked this over, and he gave us 50 cents raise to help us out.

Q. When you say "we all", who do you mean?

A. Well, I don't know how many was there at the meeting, me and my brother was the parties on our job.

Q. Were other operators there?

A. Yes, sir.

Q. And Mr. Clyborne was there?

A. Yes, sir.

Q. It shows you went along at \$4.50 per ton until October of '52, when it was increased to \$4.75. Do you know the [fol. 936] reason for that increase?

A. I am not sure about that, but I believe that was when United Mine Workers got an increase, the labor.

Q. Do you know whether the price of coal went up at that time?

A. No, I don't.

Q. You went along at \$4.75 until March 1, 1963 when it was reduced to \$4.50 per ton. Will you explain why it was decreased to \$4.50, if you know?

A. Well, they told us that the price of coal went down and they would be forced to cut the price in order to run.

Q. On January 5, 1954 the price per ton was reduced to \$4.25. Did you ascertain the reason for the decrease at that time?

A. That was the same thing again, they said the price of coal still went down, they would have to cut the price in order to run.

Q. Now, it continued at that price until April 1, 1964 when it was reduced to \$4 a ton. Will you tell me, if you know, the reason for the reduction in price to \$4 a ton?

A. That was still the same thing, they told us the price of coal had went down, they were forced to cut the price in order to run.

Q. Did you object to any of these cuts? [fol. 937] A. Yes, sir, we did.

- Q. Did you discuss them with officials of the Paragon Jewell!
 - A. Yes, we did.
- Q. Did they give you any reason for the reduction other than the price per ton?
 - A. That is all.
- Q. Other than the reduction in the market price of coal?.

A. That is all they told us the price went down until

we were forced to cut the price.

- Q. The record shows, and on matters of price, I am referring to Exhibit 74, which shows that the price that you received increased on September 1, 1955 from \$4 a ton to \$4.25. Do you know whether the coal market went up at that time?
- A. No, I don't know whether the coal market went up, but that was when United Mine Workers got a contract and increased the labor, and Mr. Clyborne gave us a 25 cent raise.
- Q. Now, going back to the first two times that the market price—the amount paid you per ton dropped, did you make any changes in the wages which you paid?

A. No, sir, we didn't.

Q. Has Paragon Jewell ever stopped you from mining on your property?

[fol. 938] A. No, sir, they haven't.

. Q. Have there ever been any temporary stoppages?

A. No, sir, there haven't except when there would be no railroad cars, there would be no work, maybe one day or two, something like that.

Q. And when they had no railroad ears, they would tell you they could not take the coal, is that right?

A. Yes, sir.

Q. What would you do then?

A. We would just knock off, we didn't work.

[fol. 939] By Mr. Merrell:

Q. I direct your attention with reference to coal that was on your right of your indicated boundary, were you ever given the right to mine coal that lay in that area?

A. Yes, sir, we was:

Q. And would you tell us who advised you that you could mine?

A. Mr. Grogan, is the one that advised us we could get that.

Q. And do you know the reasons why you were permitted to mine that coal?

A. Yes, sir, I do. .

Q. What?

0:

Mr. Katz: We object to his giving the reason from Mr. Grogan, if that is what he is going to do.

The Court: Yes, sir.

By Mr. Merrell:

Q. Who was mining that coal before you acquired the right to mine?

A. Mr. Henegar, I believe, Coal Company.

Q. How long did Mr. Henegar work on the operation?

A. I really don't know how long.

[fol. 940] Q. Was it a long time or short time?

A. No, short, not too long.

Q. Were you given any interest in his coal while he was still there?

A. No, sir, we wasn't.

Q. And after he left, what was represented to you by Mr. Grogan!

A. After he left, it was a block of coal left next to our lease that he pulled off and left, and when we drove up there to our line, we asked Mr. Grogan what about us going over and getting that block of coal and he said it was okay, that we could go ahead and mine it.

The Court: When was this, approximately, Mr. Stilwell?

The Witness: It was around, between '52 and '53, I would say.

Mr. Merrell: Were you later given the right to mine any coal that lay on your left?

A. Yes, sir, we was.

Q. And when before you were given this right, who was mining that coal?

A. Well, there were several mining that, I don't know. who all. Mr. Salvers was the first one that started on it.

Q. Do you know any other parties who mined that coal?

A. Well, I believe the company mined some in it. [fol. 941] Q. By "company", you mean-

A. (Interposing) Paragon Jewell Coal Corporation.

Q. At the time you were given the right to mine that coal, was anyone else mining it?

A. No, sir, there wasn't.

The Court: Who gave you the right?

By Mr. Merrell:

Q. Who gave you the right to mine that coal?

A. Mr. Grogan.

Q. I direct your attention now, Mr. Stilwell, to the period in, say the latter part of 1956, and if you can recall, would you tell me who was mining coal on your right at that time?

A. Lee Merritt and Wes Merritt on my right. Q. Was any other operator mining on your right on either the McNeil or Brown tracts since that time, if you know?

A. I don't know that. I don't know whether there was any more around there at that time or not.

Q. Was there anyone mining between you and the Merritt interests since that time?

A. Not that I know of.

Q. Has there been a designated boundary between you and the Merritt interests?

A. Yes, sir, there was.

Q. And has that boundary been adhered to? [fol. 942] A. Yes, sir.

Q. Has Paragon Jewell ever endeavored to negotiate a new agreement with you?

A. No, sir, they haven't.

Q. Have they ever had any discussions with you regarding a revision of the agreement?

A. No. sir.

Q. If you can recall, Mr. Stilwell, will you state how long it took you and your brother to attain your planned tonnage, which I understood was 300 tons a day?

A. Somewhere between 18 and 24 months.

Q. Is the division between your mine and Merritt mine is that located on the McNeil tract or Brown tract?

A. That is on the Brown tract.

Q. Is all of the coal you produced brought out of your mine entry?

A. Yes, sir.

Q. No other way to get the coal out?

A. No, sir, the only way we have to get it out.

- Q. What was the longest roll that you were ever in?
- A. The longest I remember, I believe was 87 feet.

Q. How long did it take you to get through it?

A. I would say around six weeks.

Q. Aside from this one payment that Paragon made to you for going through a roll, have they ever paid anything [fol. 943] to you except the amount per ton of coal delivered to you?

A. No, sir, they haven't.

Q. And this situation on their paying, did that apply to just the one roll or to other rolls?

A. Just the one.

The Court: You mean when they shared the expense? Mr. Merrell: Shared the expenses.

By Mr. Merrell:

Q. Mr. Stilwell, are you acquainted with what is called outcrop coal?

A. Yes, sir, I am.

Q. Is that coal marketable?

A. Not too good.

Q. How far back into a mine entry do you have to go before you can reach, say, what we call good coal?

- A. Well, it just depends on the location that you are in, what kind of condition the coal is in. Sometimes it is good right close to the outcrop and sometimes you have to go maybe 50 feet to clear up and get good coal, and maybe further.
- Q. Do you ever know when you are going to hit these rolls?

A. No, sir, you don't.

[fol. 944] The Court: Mr. Stilwell, will you take the stand.

Cross examination.

By Mr. Gillespie:

[fol. 947] Q. Now, you say that when you and your brother, S. W. Stilwell, were talking to Mr. Grogan about mining Paragon's coal, that there was a property map?

A. Yes, sir.

Q. That was the only map that you saw?

A. Yes, sir, at that time.

Q. At that time. Would you recognize that map now, if you saw it, Mr. Stilwell?

A. Well, I believe I would.

Q. I show you what has been introduced in evidence Joint Exhibit 58-BG, and ask you if that looks like the map that Mr. Grogan showed you at the time you say you negotiated the contracts to mine Paragon's coal for them? [fol. 948] A. No, sir, that is not the map.

Q. This is not the map?

A. No, sir.

Q. Mr. Stilwell, I now show you a blue map and ask you if you recognize that?

A. No, sir, that is not the map I saw.

Q. That is not the map either?

A. I don't think so.

Q. Are you sure that is not the map?

A. I am pretty sure it is not.

Q. Well, do you recall what there is about this map and the map you saw that distinguishes them?

A. On the map that I saw, it only had the outcrop boundary line on it. That is the one we leased the coal on.

Q. Now, Mr. Stilwell, does this map have the boundary lines and outcrop on it?

A. It has some of them on, but that is not the map I looked on when I leased the coal.

Q. You are positive of that?

A. Yes, sir.

Mr. Gillespie: Will you stipulate that the blue map is a duplication of Joint Exhibit 58-BG?

Mr. Merrell: I so stipulate.

The Court: You are stipulating that Exhibit 58-BG is a copy of the blueprint map which is an original property [fol. 949] map, I gather.

Mr. Gillespie: Were you and your brother, S. W. Stilwell together when you talked to Mr. Grogan and went on the property to look it over?

The Witness: Yes, we was.

By Mr. Gillespie:

Q. And you looked at the outcrop at two or three places and finally decided on a place that you would like to start mining?

A. We looked at one place that was faced up, and we went in the woods and picked out the next place where we

opened up.

Q. And this place you picked out was where you and your brother decided you would like to start mining?

A. Yes, sir.

Q. And you say that mine was not faced up at the time?

A. No, sir.

Q. Well, you were told by Mr. Grogan that the mine would be faced up, weren't you?

A. No, sir.

Q. You didn't wait for the company to face up the mine?

A. No, sir, we didn't.

Q. You were anxious to get started?

A. Well, we weren't too anxious, but we wanted to get [fol. 950] it done and get ready by the time they got their tipple ready.

Q. Now, Mr. Stilwell, I show you Petitioner's Exhibit No. 80, which has been received in evidence, and which you have testified had certain boundary lines that were pointed out to you and to your brother, S. W. Stilwell.

A. Yes.

Q. New, that was not the map that was exhibited to you by Mr. Grogan when you and your brother went there to talk about taking the job for Paragon, was it?

A. Not this map, no.

Q. That man was not made until sometime after you

had started mining, was it?

A. After we faced our mines up here (indicating), opening everything up, cleaned it up, and cut under the top far enough to set a spad, Mr. Belcher set this map up for us.

Q. Don't you know, Mr. Stilwell, that the line which has been marked with the red letter "A" to the right, and which you say was the boundary line is nothing but a barrier?

A. Well, the map that I looked at had this outcrop line all the way around and this lease line between the Brown heirs and McNeil tract was on the map. Mr. Grogan, he called it a slunge.

Q. Do you know what he was talking about?

A. Yes, sir, that is what I did, that is what we call a [fol. 951] hollow. We laid his hand on the map and said we could go straight up with this line here and straight on back to the Brown heir tract of coal. He laid his hand on the other side over here and said he was putting in another mine, this was here, was the one that was faced up and we looked up-we could come up over here and stop and go straight back to this lease line.

Q. Now, Mr. Stilwell, will you answer my question? Don't you know that the line which has been marked with the red letter "A" on this map is nothing but a temporary

barrier that was put on this map by the engineer?

A. The engineer put it on there, we understood it was a boundary line, that was as far as we could go.

Q. You are used to looking at maps, aren't you!

A. Yes, sir.

Q. You know barrier lines and project lines when you see them on the map, don't you?

A. Yes, sir, I do.

Q. Now, isn't that line which has been designated with a red letter "A" nothing more nor less than a temporary barrier?

A. That was intended for a boundary and a barrier between the two mines.

Q. As a matter of fact, Mr. Stilwell, that line has been changed since it was put on there, hasn't it?.

[fol. 952] A. Well, I don't know about the line being changed on the other map, but it has not been changed on this map.

Q. Have you stayed within the limits of that line?

A. Yes, sir. At the time we was mining this block of coal, we did.

[fol. 959] Q. Now, when you went there, Mr. Stilwell, you and your brother knew that you both had considerable experience in mining coal?

A. Yes, sir.

Q. And you had experience in mining the Jewel Seam of coal?

A. Yes, sir. .

Q. And you were convinced in your ability to do as good a job to mine that coal as the next man?

A. We felt that way.

Q. You felt that you could get that coal if anybody could?

A. Well, we felt like we would like to try it. We didn't

know whether we could or not.

Q. Your previous experience had caused you to have the confidence that you could go in there and make some money mining that coal?

[fol. 960] A. We didn't know about making the money,

but we was going to give it a try.

Q. If you hadn't felt you could make money you would not have been interested in going in?

A. Of course we thought we would make some.

Q. And you have been successful, havn't you, Mr. Stil-well?

A. We have kind of got by.

Q. Now, of course as long as you're making money, you wouldn't consider stopping, would you?

A. No, sir, we wouldn't.

Q. Of course it is true that Paragon Jewell Coal Company had this considerable acreage of coal and they wanted it mined?

A. I suppose they did.

Q. And as long as the arrangement was profitable to Paragon, it would have been rather foolish to have stopped it, too, wouldn't it?

A. I think so.

[fol. 961] Q. It is a fact, Mr. Stilwell, that you were required to take all the coal that you mined to Paragon's tipple?

A. Yes, sir, it was.

[fols. 966-968] Q. Now, Mr. Stilwell, to whom do you look for your money when you mine that coal and deliver to Paragon's tipple!

A. When we haul our coal down to tipple, we look to

Paragon Jewell Coal Company for our money.

Q. Do you look to anybody else whatsoever for any part of your money for mining that coal?

A. No, sir, we don't.

- Q. Isn't it a fact that when you deliver a load of coal to that tipple, you know exactly what you are going to receive for it?
 - A. After it is weighed, we do.

Q. After it is weighed?

A. Yes, sir.

[fol. 969] Q. Nothing further that you have to do?

A. No, sir

Q. You don't know what Paragon does with it at all?

A. They put it through the tipple, I don't know where it goes to then.

Q. You don't know whether they sell it at a profit or loss, or what they do with it, do you?

A. No, sir, I don't,

Q. Did you ever buy any interest in this coal there in place?

A. No. sir, we didn't.

Q. Did you ever in any way acquire any title or interest

in that coal in place?

A: The only thing we did, we leased the coal and we bought our equipment and set up to mine the coal for the company.

Q. Now you say you leased it. What royalty did you pay?

A. Well, we didn't pay any royalty, that was figured in the price, the way the contract was set on the start of the mine.

Q. You say you paid no royalty?

A. No, sir.

Q. Did you pay any rent?

A. No. sir.

[fol. 970] Q. Did you pay taxes on the land?

A. No, sir.

Q. What consideration did you pay, if any, for-

A. (Interposing) We pay our own taxes on our equipment, we pay the workmen's compensation, we also pay the social security, the unemployment tax.

Q. But all of those are costs that have no connection with the body of coal that is under the ground there, aren't

they?

A. We pay all labor that it takes to mine the coal and

our own expenses.

Q. And all the labor, all your insurance costs, all your power, those things your supplies, you charge off to the expense of operation, don't you?

A. Yes, sir.

Q. And all of the equipment that you have purchased, you depreclate that?

A. Yes, sir, equipment, yes, sir.

Q. You say there was nothing said about termination?

A. No, sir.

Q. You knew that you could quit any time you wanted to, didn't you?

A. We didn't know whether we could or not, nothing was said about that.

[fol. 978] Q. And the \$100,000 that you spent to get set up for mining was all in an appreciable extent that has now been depreciated down to about \$2,000, hasn't it?

A. No, sir, I don't think so.

Q. It has always been depreciated, hasn't it, and is being depreciated?

A. Yes, sir.

Q. Every hit of it? Isn't that right? That is correct, isn't it, Mr. Stilwell?

A. I don't understand your question.

Q. I say, every cent of money that you invested to get ready to mine has been in equipment that you have taken depreciation on every task used?

A. No, sir.

Q. What is it that you have not depreciated?

A. Well, we have to buy a lot of timbers and stuff like that we don't depreciate it.

Q. You charge that off to expenses and supplies, don't

you!

A. Yes, sir.

[fol. 979] Q. Mr. Stilwell, do you say you have a certain area that you are supposed to mine all the mineable coal, is that correct?

A. That is correct.

Q. How much of the coal under that area are you sup-[fol. 980] posed to mire?

A. We was supposed to mine all mineable coal.

[fol. 984] Q. Mr. Stilwell, I may have asked you this, I am not sure, could you take the coal which you mine from Paragon's lands any place except to Paragon's tipple?

A. Well, there was never nothing discussed on that. I don't know if we couldn't sell the coal, we might work out an agreement to take it some place.

Q. I am talking about under the agreement you had

with Mr. Grogan?

A. We never did want to take it anywhere else. They have always handled all the coal we have mined. We had no cause to take it anywhere else.

Q. You have stated there were times the tipple was [fol. 985] closed down and you had to knock off and quit?

A. We didn't want to work.

Q. Now, have you ever given any consideration to taking that coal any place else?

A. No, sir, we haven't.

Q. You knew that you had to take all of that coal to Paragon's tipple?

A. No, sir, we didn't because nothing was said about

that.

Q. If you took it some place else, what would you have paid for it?

A. That would be an agreement between us and the company, but we never had no cause to do that.

Q. That is not included in any agreement you had?

A. No, sir, no, sir, nothing said about we had to take it all there or not.

Q. You were told by Mr. Grogan that you would be expected to bring all the coal you mined to Paragon's tipple?

A. No, sir.

Q. Your statement is that he told you he would handle all the coal—

A. (Interposing) That we could mine.

Q. That you could mine? .

A. Yes, sir.

[fol. 986] Q. And in all the ten years that you have been mining, you have never taken a lump anywhere else?

A. Nothing except when we first opened up, we had some outcrop coal, while we was getting the tipple, Mr. Woods or Mr. Grogan one had my brother to haul a load to Mrs. McNeil for house purposes.

[fol. 987] Redirect examination.

By Mr. Merrell:

[fol. 988] Q. Have you ever been accused of not mining all the mineable coal by Paragon?

A. No, sir, we haven't.

Q. You mentioned driving through these rolls, why, you said, I believe, it was your practice to always to through them. Why were you willing to drive through them?

A. Well, we expect when we drive through to hit coal on the other side.

Q. Do you mine on rubber or rails?

A. On rails.

[fol. 994] The Court: Just one question, Mr. Stilwell, you mentioned, I-believe it was on direct examination, or maybe on cross-examination, about pulling the pillars without getting anybody's permission to do so. It was my understanding you testified that you left enough to leave the mine safe?

The Witness: That is right.

The Court: In other words, you did not pull pillars that [fol. 995] would permit the roof to fall?

The Witness: That is right.

The Court: Thank you, Mr. Stilwell.

LEE MERRITT was called as a witness by petitioner [Merritt] and having been first duly sworn, testified as [fol. 996] follows:

Direct examination.

By Mr. Merrell:

Q. What is your business, Mr. Merritt?

A. Truck mining operator:

Q. I believe the stipulation shows that during the period here involved, that you were a partner in Standard Smokeless Coal Company!

A. That is right.

Q. And Kyva Mining Company?

A. No, sir, I was not a partner in Kyva.

Q Were you a partner in the Far West Mining Company?

A. Yes.

Q Where is the Standard Smokeless Coal Company mining coal at the present time?

A. Near Whitewood, Virginia.

Q. Is that on property that is under lease to Paragon Jewell!

A. Yes, sir.

Q. When Standard Smokeless started mining coal on

this property!

A. Well, the best I can remember, I believe I started [fol. 997] building my buildings and tipple, and set up in June of 1953.

Q. And have you mined since then?

A. Yes, sir.

Q. What kind of agreement have you mined under! Is there a written agreement or oral?

A. Oral.

Q. With whom did you negotiate that oral agreement?

A. Mr. Grogan.

Q. When did you negotiate it?

A. Started negotiating, I guess, along sometime in June of '53.

Q. Where did those negotiations take place?

A. There on the job.

Q. Will you tell us what you were doing before you went to the Paragon Jewell property to investigate a possibility of a mining operation there?

A. Truck mining in Kentucky.

Q. And why did you leave Kentucky?

A. Well, business got bad in Kentucky and work in coal business was kind of bad at that time of year.

Q. Did you have any operation over there you were.

A. Yes, sir.

Q. What was the name of that operation?
[fol. 998] A. Elchorn Creek Colliers Incorporated.

Q. Then when you went over to the coal properties, who was the first official of Paragon Jewell you contacted?

A. Mr. Grogan.

Q. And will you state what transpired between you and

Mr. Grogan?

A. Well, when I went there, I met Mr. Grogan. First how come I got there, a mining inspector, compensation inspector, advised me if I was looking for some coal to lease, to go up and see Mr. Grogan, he was putting in a new job there, and for steady work, the future looked pretty good.

I went up to see Mr. Grogan and I met him on the job. I told him I was a truck miner and truck mining in Kentucky and if he had any coal to lease to a truck miner. He said he did if I could meet his requirements.

Q. Did he state what those requirements were?

A. Yes, sir.

Q. What were they?

- A. He wanted me to be financially able to buy the proper equipment to mine that coal with, such as air compressor, good equipment to show him that I could mine coal and would mine coal.
 - Q. Were there any other requirements?

A. I just can't remember offhand.

Q. Did you negotiate an agreement, reach an agreement [fol. 999] with Mr. Grogan?

A. Yes, sir, after three or four months negotiating—after three or four weeks negotiating.

Q. You talk with him off and on for three or four weeks?

A. Yes.

Q. Then you reached an agreement?

A. Yes.

Q. Could you fix approximately the time when you reached this agreement?

A. Well, it must have been, when I finally decided to

start, it must have been sometime in July.

Q. What were the terms of this agreement, first with reference to the area of coal that you would be mining?

A. Well, when I went there, the location that I am on, they didn't have the road out to it. And he told me we went around to the end of the road, where they was building the road at this time just as quick as he got out here far enough, for a location for me, we would go up and look at the coal, that they would build the roads, maintain the roads, face up the coal, to where I was going in, and I would be charged a small fee for that, but not to worry about it, until after I got going.

Then when they got the road out to the location, and they got the coal faced up, he went up and he and I went [fol. 1000] together, and he, they didn't have any map at that time, or at least he didn't show me one. He laid me

off an area with his hands, up between two hollows, and told me that—I told him that I didn't just a small area of coal, that there was three of us go to be partners and we couldn't make any money without me running coal. And he assured me I would be laid off enough coal to run at least 150, 200 tons a day for five or six years.

Q. Now, what were the terms of that agreement with reference to what coal you were to mine within the area

indicated?

A. I don't know whether you-I understand you.

Q. Were you required to mine all the coal?

A. I was supposed to mine it according to State mining law, and all mineable coal.

Q. And who was to have responsibility for the operation of your mine?

A. I was.

Q. Was anything said regarding the engineering services that would be needed inside the mine?

A. He said that they would provide an engineer, and

I would be charged three cents a ton. .

Q. And what about, was any arrangement made regard-

ing power?

A: Well, he said they had a transmission line, I would [fol. 1001] have to furnish my own substation, and AC power, where he set the last pole, I had to take on from my expense.

Q. They offered to sell you power to a certain point?

A. That is right.

Q. And you could buy, how were you to pay for that

A. So much a ton.

Q. Now, was anything said with reference to the disposition of the coal after it had been mined?

A. I don't understand your question.

Q. What was your—if anything—was your agreement or what was told you by Mr. Grogan as to what would be done with the coal after you mined it?

A. Well, they was wanting coal there and he was always

wanting more coal than I could run.

Q. Did he make any representation as to what Paragon Jewell would do regarding the coal that you mined?

A. I would mine the coal and haul it down to their tipple.

Q. What would they agree to pay you for the coal?

A. You mean the price? .

Q. Yes.

A. I would be paid every two weeks, at this time, I believe it was every two weeks. [fol. 1002] Q. Under that agreement, what were you to do with the coal after you mined it?

A. After I mined the coal?

Q. Yes.

A. I was to haul it down to Paragon Jewell's tipple.

Q. And did they make any representations to you as to how much of your coal they would take?

A. They wanted more than I could mine, always wanted

more than I could mine.

Q. How did they agree to compensate you for coal which you mined?

A. They paid off every two weeks.

Q. How was the payment based? A. Well, he said my price would be based on the market price of coal.

Q. What would happen if the market price went down?

A. Well, I guess we went down.

Q. And if it was increased, what would happen?

A. We went up.

Q. And you were to be paid on a tonnage basis?

A. That is right, so much per ton.

Q. What kind of mining did this agreement contemplate, a strip mining or deep mining?

A. Deep mining.

[fol. 1003], Q. Now, when you and your partners started the Standard Smokeless operation, did you have any planned tonnage figure which you hoped to attain?

A. Yes, sir.

Q. What was that?

A. From 150 to 200 ton a day.

Q. Do you know how long it took you to attain that tonnage?

A. Well, I don't know, I would have to look at the records, but probably a year.

Q. How far back into the mountain have you driven

at this time?

A. I could measure it on a map, I guess about 3,000 feet.

Q. That is referring to the Standard Smokeless?

A. That is right.

Q. Now, when you started mining, was there an operating mine on your right?

A. Not when I started there wasn't anything on my right.

Q. Was there an operating mine on your left?

A. Yes, sir.

Q. Who was operating that mine?

A. Martin, Harry Martin.

Q. And was there any proposed mine between you and

[fel. 1004] Mr. Martin?

A. Yes, sir, later, after I got started, this Martin I don't know what happened to him, they put a proposed mine between my mine and his mines, but on the left of the hollow, that they laid out for me.

Q. When you started, did they tell you how far back

into the mountain you could drive?

A. Well, something he said, around 3,000 feet.

Q. Did they tell you how far you could go to the right and to the left?

A. Oh, yes.

Q. Did they submit to you a map?

A. When they brought my first map, it had it on there how far to the left and right, I could go.

Q. After you obtained this agreement with Mr. Grogan,

what did you do in order to get into operation?

A. Well, I built a shop, tipple, substation, and proceeded to start taking coal out of the mine.

Q. Why did it take you approximately a year before you got up to your planned tonnage?

A. Wello I shad to get my mine developed to get in far

enough to get working places.

Q. You are also a partner in the Far West Mining Company, isn't that right?

A. When Far West first started I was, not at this [fol. 1005] time, no.

Q. You were when it was first started. Do you recall when that was?

A. Lwould have to guess. I believe in '56.

Q. Late in '561

A. I believe so.

Q. Is Far West Mining on Paragon Jewell's leased property!

A. Yes, sir.

Q. And they started mining when it was sometime in the latter part of '56, do you remember?

A. I believe so.

Q. Did—how many mines is Far West operating at the present time?

A. Really, I don't know right now.

Q. You are not a partner now?

A. Not a partner.

Q. How many was it operating when it first started operations on Paragon?

A. I believe three.

Q. Three!

A. Yes.

Q. Did it establish these mines or did it acquire them from another party?

A. Acquired it from another party.

[fol. 1006] Q. Who was that party?

A. Sherman Meadows.

Q. Was he operating on the property before Far West acquired it?

A. Yes, sir.

Q. How did you acquire them?

A. Well, I met Mr. Meadows one day in Raven and he told me he was wanting to sell out.

[fol. 1007] The Witness: It was on a Sunday, I met Mr. Meadows in Raven and he and I had been talking a little bit about this deal. Mr. Meadows claimed he had more business than he could take care of and he was going to have to turn some of it loose. I told him if the price was right for his mines, I might be interested in it. And I met Mr. Meadows on this day and he said he had definitely decided

to sell. We arrived at a price, and I was on my way to Bluefield at that time, so when I got in Bluefield, I called Mr. Woods, and told him that I had met Mr. Meadows in Raven and Mr. Meadows was wanting to sell me his mines. And if it would be—if he thought it would be all right for me to buy Mr. Meadows mines, and he said he would be glad for me to, that they wanted coal from out there.

So, I came back and I told my brother about it and my brother and I and Mr. Bowling and we decided to become

partners.

By Mr. Merrell:

Q. What did you tell Mr. Woods?

A. I told Mr. Woods I talked to Mr. Meadows and Mr. Meadows wanted to sell his mines and if he thought it [fol. 1008] would be all right for me to buy. He said it would be all right for me and Wes and Mr. Bowling to buy it, be glad for us to have it, that they wanted to get coal out of there.

Q. Did you and the other partners in Far West at that time enter into an agreement with Mr. Meadows?

A. Agreement with Mr. Meadows?

Q. Yes.

A. Yes, sir.

Q. Was that agreement in writing?

A. Yes, sir, as far as price.

[fol. 1011] By Mr. Merrell:

Q. Prior to your entering into the agreement with Mr. Meadows, which is Petitioner's Exhibit 84, did you take any steps to ascertain the area of coal that Mr. Meadows was entitled to mine?

[fol. 1012] A. Yes, sir, I knew that.

[fol. 1013] By Mr. Merrell;

Q. First, did you take any steps to ascertain this area?

A. I knew the area.

Q. How did you know the area?

A. Well, I was mining there close by, and I was keeping a close eye on it.

Q. Well, what did you—from what did you determine the area!

A. From the map.

[fol. 1018] By Mr. Merrell:

Q. Under your agreement with Mr. Meadows, what were you bu ing from him?

[fol. 1013] A. Well, I was buying all of his holdings there where he was at and mainly the mines. I didn't have any use for equipment, but we did buy the equipment with the mines.

Q. Why were the mines of so much importance to you?

A. Well, there was a lot of coal there to mine.

[fol. 1021] Q. When you were negotiating your agreement with Mr. Grogan, did he say anything to you about a right on the part of Paragon to terminate the agreement?

A. No. sir, we never discussed that.

- Q. Did he say anything about the right of either party to claim depletion on their production?
- A. No mention.
- Q. When you bought out the Far West Mine, was there anything said by Mr. Woods when you talked to him regarding termination?

A. No, sir.

Q. When Far West bought out the Meadows Mine?

A. No, sir.

Q. Was anything said at that time regarding the right of either party to claim depletion?

A. No, sir.

Mr. Merrell: That is all.

Cross examination.

By Mr. Gillespie:

[fol. 1023] Q. You asked him if Paragon had some coal that you might mine for him?

A. I asked him, did he have some coal to lease to a truck mine operator.

Q. Well, you asked him if he had some coal to lease?

A. That is right.

Q. It is your contention, I guess, that you lease some coal?

A. Right.

Q. Is that right?

A. That is right.

Q. What did you pay for the lease?

A. Well, I didn't pay anything.

Q. Did you agree to pay any royalties for it?

A. No, sir, it wasn't discussed.

Q. Pay any rent?

A. No, sir.

Q. Pay anything for it?

A. Well, I don't know what Sur question is—I didn't pay anything.

[fol. 1028] Q. Now, Mr. Merritt, do you say you don't recall anything being said about termination?

A. No, sir.

Q. Not as long as you continued to make money, you wouldn't be interested in stopping, would you?

A. Well, I wouldn't think so. ..

Q. And as long as you are producing a sizeable amount of coal and delivering it to Paragon's tipple, you see no reason why they would be interested in stopping you, would they?

A. No. sir.

Q. Because that is what they are there for, to get all of the production that they can get?

A. I imagine so.

Q. They are constantly urging you to increase?

A. That has always been the case; yes, sir.

[fol. 1029] Q. Mr. Merritt, you have also testified that the prices which you were paid for mining and delivering this coal to Paragon's tapple has gone up and down some eight or nine times since you have been there, is that correct?

A. I don't know whether I said eight or nine times or not, but it has went up and down.

Q. How many times has it gone down, do you recall?

A. I just couldn't recall; I would have to refer to the books.

Q. Well, there have been one or two occasions when you protested pretty strongly about the price going down, haven't you?

A. Well, I don't know whether I protested too strong or not, but I am always interested in getting all the money

out of my work I can for my coal.

Q. When the price got down to \$4.00 a ton, there in 1954,

didn't you object very strenuously to it?

- A. I just can't remember objecting very strenuously, but I guess if I talked to one of the Paragon Jewel officials, I imagine I was always wanting more money.
 - Q. Always wanting more money?

A. I guess so.

Q. You don't remember objecting to a cut in the price [fol. 1030] that they imposed there at one time?

A. I don't know to just what you are referring to about strenuously.

Q. Well, did you object at all?

A. Sure, I'm sure I object any time they cut me.

Q. Every time the price went down, you are sure you objected?

A. I imagine I did.

Q. They didn't raise the price when you objected, did they?

A. No, sir.

Q. Yet you continued to deliver that coal to Paragon's tipple, didn't you?

A. That is right.

Q. The reason was that your oral agreement with Mr. Grogan required you to deliver all of that coal to Paragon's tipple, didn't it?

A. My agreement with Mr. Grogan that they would take

all the coal I could mine.

Q. Do you mean to imply to this Court that you had the right to take the coal anywhere else?

A. That was never discussed.

· Q. Well now, if the price which Paragon agreed to pay was cut to the place where you objected, why didn't you take your coal some place else to see if you could get [fol. 1031] a higher price?

A. Paragon was paying more than the other places in

the area was paying.

Q. Has that always been true?

A. To the best of my knowledge it has always been true.

Q. Have you ever gone to any other place to inquire as to what they were paying?

A. When you say go, I pay pretty close attention to

all of them.

Q. Have you ever gone to any other coal producing plant in that area and inquired as to whether or not they were paying more than Paragon was paying you for producing the coal at any time?

A. Well, just who would you mean, who did I go to?

Q. Anybody, Jewell Smokeless, Jewell Ridge, any? A. That is public knowledge all the time what they are paying.

Q. Would you mind answering my question, have you ever gone to any of those places to find out what they were paving?

A. No. sir, not directly to any company official that I

can remember of.

Q. Isn't it a fact that the reason you never made any inquiry was because you knew you had to deliver this coal [fol. 1032] to Paragon's tipple because it was their coal?

A. Because they was paying me more for it than the

other places were paying.

- Q. What did you have to do in order to be entitled to your money?
 - A. What did I have to do?

Q. Yes.

A. You mean from Paragon Jewel?

Q. Yes.

A. I had to deliver them the coal.

Q. You had to mine the coal and deliver to its tipple?

A. That is right.

Q. Then you felt that you had fulfilled your part of the contract?

A. Well, when I delivered the coal and went over the scales, I felt that I was entitled to my pay for it.

Q. You were entitled to your pay for it. And you didn't look to anybody else whatsoever for your money, did you?

A. Not for coal when I took it to Paragon Jewel; no, I

wouldn't look to anyone else.

Q. And you had no way of knowing what Paragon Jewel did with the coal, whether they sold it at a profit or loss or what they did with it, did you?

A. Nothing positive; I wasn't positive, but I'don't believe

[fol. 1033] they lose.

Q. But you never at any time knew what the price was that Paragon received for the coal if they sold it?

A. Not definite.

Q. At the time you dumped your coal into Paragon's tipple, you knew exactly how much you would receive for that particular coal, didn't you?

A. Yes, sir.

Q. They never changed the price at any time without giving you notice in advance, did they?

A. That is right.

Q. Mr. Merritt, you say that you had some area or boundary of coal which you say Mr. Grogan laid out with his hands?

A. That is right.

Q. That was the manner in which this area or boundary was described you at the time you originally negotiated this agreement with him?

A. Yes, sir.

Q. Did you have any agreement or understanding with them as to what your obligation would be if you failed to mine all of the mineable coat in the area which you say be laid out with his hands?

A. Why, my agreement with him, I felt I was obligated to mine the coal in a mining-like way according to state

[fol. 1034] mining law.

Q. Did he ever tell you if you didn't mine you would have to pay for it?

A. I don't believe that was discussed.

Q: That wasn't discussed?

A. No, sir.

Q. So he didn't tell you you were compelled to mine all the mineable coal in any given area, did he?

A. Yes, he said I would be bound to mine all mineable

coal.

[fol. 1037] Q. You have stated that at the time Far West bought out Meadows, that you didn't consider that equipment worth anything?

A. That is right, truthfully I didn't, but I think we did put a value on it, maybe \$5,000 or \$6,000, but without the

mines, I wouldn't give a thousand dollars for it.

Q. Mr. Merritt, that \$21,000 you say you spent for the Meadows Mine, you depreciated in your tax return for that year as equipment, \$21,000, didn't you?

A. You will have to ask Mr. Persinger about that.

Q. In other words, you didn't spend any \$21,000 for something there and then not take depreciation on it, did you?

A. Now you are getting too deep for me. You will have

to talk to him about that.

Q. Who furnishes Mr. Persinger with the information on which he makes the returns?

A. My bookkeeper.

[fol. 1039]

By Mr. Gillespie:

Q. You say that you had already looked over Mr. Meadows' operation before you talked to him on this subject at Raven, Virginia about buying?

[fol. 1040] A. I was pretty familiar with what he had out

there.

Q. You considered that he had some definite area of coal?

A. Sure.

Q. That he could mine?

A. Yes.

Q. That was what you were buying and not the machinery?

A. That is right.

Q. If you felt that he had something which he was entitled to sell, why did you go to Bluefield and ask Mr. Wood for permission to buy?

A. Well, I figured that Mr. Meadows was leasing from Paragon Jewel and I wanted to see if it was okay for me to take his lease over.

Q. If it was his, he could dispose of it in any manner

he wanted to, couldn't he?

A. But he had—I figured he had a lease just like I did, nothing in writing, so I thought I better be sure of it.

[fol. 1042] G. W. MERRITT was called as a witness on behalf of the petitioner [Merritt], and, having been first duly sworn, testified as follows:

Direct/examination.

By Mr. Merrell:

Q. You are one of the petitioners in this case?

A. Yes, sir.

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Q. What is your occupation?

A. Mining, mine operator.

Q. During the years 1954, '55 and '56, you were a partner in Standard Smokeless Company?

A. Yes, sir.

Q. Which mined coal on the Paragon Jewel lease?

A. That is right.

Q. Did you hear the testimony of your brother, Lee Merritt, regarding the negotiations with Mr. Grogan?

A. Yes, sir.

Q. Did you ever discuss this agreement with Mr. Grogan [fol. 1043] before Standard Smokeless went on the job?

A. Yes, sir, about the time they was going on the job.

Q. Was that after your brother had been over there discussing it?

A. Yes, sir.

Q. Now when you discussed this agreement, did Mr. Grogan advise you as to any specific area of coal that you would be entitled to mine?

A. Yes, sir, he laid out a certain boundary of coal, when we did get up on the hill, a certain boundary of coal we

could mine.

Q. What did he say with reference to the responsibility

for the mining operation?

A. Well, as I remember, he said that the company built the roads and maintained them and that they would build a supply road and face the coal up; that they would probably make a small charge for building the supply roads. And after they faced the coal up, from there on, it was ours, it was our responsibility.

Q. Who was to pay for the engineering services?

A. We were.

Q. Who was to obtain the mining permits?

A. We were.

Q. Who was to be responsible to the state and Federal Mine Inspectors?

[fol. 1044] A. We were.

Q. What was said with reference to the disposition of the coal after you had extracted it from the ground?

A. Well, as I remember it, Mr. Grogan said that they would buy all the coal we could produce and deliver down to their tipple.

Q. What was said regarding the price that they would.

pay for coal delivered?

A. Sir, he said the price would be governed by the fluctuation of the market.

Q. What was to happen if the market went bad?

A. Well, the price would go down.

Q. And if the market went up?

A. We would get an increase.

Q. During the period of time that you have been mining there, has the price Paragon Jewel has paid to you changed?

A. Oh, yes.

Q. What has been the basis of these changes, if you know?

A. Well, to the best of my knowledge, it has been general market conditions, the demand for coal, and most of the time, when the union would get an increase, why we generally got an increase there.

Q. Now, when you were talking with Mr. Gorgan, did [fol. 1045] he say anything regarding the rights of termi-

nation of the agreement?

A. There was nothing mentioned about termination of agreements.

Q. Did he encourage you to take the operation?

A. Well, Mr. Grogan, he seemed to be very pleased that we came over there after he found out that we were miners down in Kentucky because he left the impression with me that he was wanting some coal and he was very eager for us to get started on the operation.

Q. Was anything said at that time regarding depletion?

A. No, sir, never mentioned at that time.

Q. Did Mr. Grogan offer you one or two mine operations?

A. We asked him for two locations when we talked to him, told him we would want two.

Q. Did he agree to give you two!

A. Yes. sir.

Q. I believe the first one was Standard Smokeless?

A. That is right.

Q. What was the name of the second operation?

A. Kyva.

Q. When did you talk with him about the Kyva operation ?

A. Well, it was immediately after Standard, sometime after Standard went in. They were building a road around the mountain. They weren't progressing too fast with the [fol. 1046] road, but after we got our Standard mine started, then I believe it was in early next spring, sometime in '54, we decided on the location for Kyva. The first one Mr. Grogan laid out for us we wouldn't accept because it was too close to Standard.

Q: That was the first location he laid out for Kyva?

A. Yes, sir, the first location he laid out for Kyva.

Q. When you wouldn't accept that, what did you do? A We started walking around the hill, Mr. Grogan and Mr. Watson and I believe were together, and we walked for some distance and he seemed to think we was getting too far, but we coaxed him to walk a little further and finally we come to a point where that was the limit and he said, "This is plenty." He said, "You have 100 acres of coal here," and he laid it out from this hollow to this hollow out here, on his left, and that was to be the Kyva Mine.

Q. Thereafter, did you start your operations in Kyva?

A. Right away, we started working on it.

Q. Did they submit a map to you showing the area involved in the Kyva Mine?

A. Not at that time they didn't.

Q. Later did they?

A. Yes. .

Q. I hand you Petitioner's Exhibit 81 and ask you to [fol. 1047] indicate on there which is the Kyva Mine?

A. Number six.

Q. I'm going to put a "K" by number six there. Now, Mr. Merritt, will you show me what you understood to be the boundary of the Kyva Mine at the time this map was submitted to you?

A. The boundary of the Kyva Mine at the time it was

shown to us?

Q. Yes.

A. You can see here, there is a little ravine here.

Mr. Katz: What?

The Witness: Little ravine right here, little hollow.

Mr. Katz: (Interposing) Mr. Examiner, we object.

There is nothing there.

The Witness: Sir, if you was on the property, you could see the ravine here. There is a culvert under the road right here at this spot.

The Court: That is right above the letter "K"?

The Witness: That is right.

By Mr. Merrell:

Q. Make a small "x" right there. From that "x" show us the right boundary of the Kyva Mine, as you understood it? Mark that with a "B."

A. This (indicating) is it.

[fol. 1048] Q. Now show us on the other side, the left side, the boundary between the Kyva Mine and the other operation, shown there?

A. Right here (indicating).

Q. That is the area there which has been indicated "D."

A. That is right.

Q. Who owned the mine on the left of the letter "D"?

A. We did. That was my brother and Mr. Watson.

Q. Standard Smokeless Mine?

A. That is right.

Q. Who owned the mine on the right of the letter "B"?

A. At that time it was owned by Sampy Lester.

Q. Did the Kyva Mining Company acquire what interest Mr. Lester had in the mine on the right which is mine number seven?

A/I believe we bought him out in early '56. I'm not sure.

Q. You bought him out in early '56?

A. To the best of my memory.

Q. Thereafter, did you mine the coal in mine number seven?

A. Oh, yes, we mined that.

Q. Is Kyva still operating on Paragon Jewel property?

A. No. sir.

[fol. 1049] Q. Why not?

A. It is worked out.

Q. Now in working out the Kyva Mine, did you mine the coal within the boundaries you have here indicated?

A. We did.

Q. After you had driven up and mined this coal, then what did you do?

A. Well, just before we mined out here, we bought Mr.

Sherman Meadows-

Q. (Interposing) I'm talking on the Kyva operation, did you pull back after you mined out?

A. After we mined out-

Q. Up?

A. Yes, after we drove up, then we pulled the pillars back.

Q. Did you obtain all mineable coal in the area allocated to Kyva?

A. Yes, sir.

Q. Was Paragon Jewel satisfied with your mining and working out of the Kyva Mine and the addition of the Sampy Lester Mine?

A. I think they were.

Q. You do know about when the Kyva Mine was worked out?

A. Best I can remember is sometime in '57 or maybe [fol. 1050] early '58, somewhere along in there.

Q. You have mentioned Standard Smokeless and Kyva. Did you acquire any other operations on the Paragon Jewel property?

A. Other than Standard, Kyva, yes, sir, we bought Mr.

Meadows out.

Q. That was the Far West Mine?

A. We made that the Far West Mine; yes, sir.

Q. When you bought out Mr. Meadows, what did you obtain from him?

A. Well, we got a bunch of pretty well worn out equipment and a lease that he had out there and a nice block of coal that we thought was a nice block of coal.

Q. Did you ever discuss that block of coal with Mr.

Frank Woods!

A. Yes.

Q. Did he make any statements with reference to that block of coal?

A. Well, he said he would like to see us buy Mr. Meadows out. He would like to be getting some coal from there.

Q. Did he make any other statements regarding the block of coal?

A. He said it was one of the largest blocks of coal left in the Brown tract on that side.

[fol. 1051] Q. Now, I believe the evidence shows that you bought out Mr. Meadows in November 1956?

A. I believe that is right.

Q. Thereafter, when was the first map submitted to you showing the Far West operation?

A. I imagine it must have been in maybe January of '57.

Q. When you saw that map, did it cause you any concern?

A: Yes, sir, very much.

Q. What was the reason for that concern?

A. Well, the area had been reduced considerably from what we thought.

Q. From what you thought it was before you purchased it?

A. Yes, sir, from what we had been showed it was after we had bought the mine.

Q. What action did you take with reference to that problem?

A. We immediately went to Mr. Woods with the map that was presented to us with the reduced area.

Q. Who is we?

A. That was my nephew, Virgil Bowling there.

Q. He was a partner in Far West?

Q. That transpired when you took this matter up with Mr. Woods? [fol. 1052] A. Mr. Woods said that Mr. Belcher knew it

wasn't right, we still had original boundaries he showed us we had.

Q. Was the map changed to reflect the original boundary?

A. Now how is that?

Q. I believe you testified Mr. Woods said that Mr. Belcher was not right in reducing the boundary?

A. That is right; that is right.

Q. Was the original boundary reestablished?

A. He said it still was where he showed us it was.

Q. Now if you can, let me ask you first, on this boundary you are talking about, who was mining on the other side of this, what you understood to be the boundary line!

A. Now which other side? You mean on the other side

of the mountain?

Q. No.

A. Or to our right or the left? That is the only place it could have been.

Q. To your left?

A. To my left, that would have been Standard Smokeless to my immediate left.

Q. Then next to Standard Smokeless?

A. That would have been Bare Ridge in behind Standard.

Q. Now this boundary that you said was mistakenly put on this map, as you viewed it, did that separate your mine and what other mine? . .

[fol. 1053] A. ladidn't separate our mine from any other mine. It just cut off the boundary-he just cut off the boundary on the right.

Q. And gave you less coal than you thought you had

under the Meadows agreement?

A. Oh, yes, oh, yes.

Q. Now when you started the Kyva operation, did you have any planned production tonnage which you hoped to attain?

A. We did.

Q. Do you recall what that was?

A. Well, sir, on the Kyva operation we put in, it was kind of something new to us. When we put the Standard in, we put it in on rubber equipment.

Q. Yes.

A. Well, Mr. Grogan, he wanted to see us putcin one like the Stilwell boys. He always held them out as his example of mining coal in a thin seam, in the Red Ash Seam. Well, when he showed us this, when he showed us the Kyva operation, he laid it out and told us we would have what we thought was 100, acres. Really, the day we walked around that mountain, we walked and stood around there and I thought it was 100 agres. We started buying equipment for tracking. He wanted us to put in a track mine.

Q. Had you ever mined on a track before?

A. Oh, yes. [fol. 1054] Q. Had you ever mined this seam of coal before except for Standard Smokeless?

"A. No, sir.

Q. Did you attempt to put in Kyva on tracks?

A. We did.

Q. Was that enterprise on tracks successful?

A. No, sir, no, it was not.

Q. And when you decided it was unsuccessful, what ac-

tion did you take?

A. Well, we went to try to get rubber tired equipment, and we were so far in the hole then that we really thought we were broke up, we was about, as I remember, some \$20,000 in the hole.

Q. On the Kyva operation?

A. Yes.

Q. And after you started the rubber operation, did your situation change?

A. Changed somewhat, yes, sir.

Q. For the better?

A. Yes, sir.

Q. And now at the beginning, what did you plan your expected tonnage to be?

A. We figured on around 150 to 200 ton out of each

operation.

- Q. Did you ever reach that tonnage, if you know? [fol. 1055] A. We did at Standard, but we never did at Kyva.
 - Q. You were never able to reach it?

A. I don't think we ever did.

Q. Are you still mining coal in Far West?

A. Yes, sir.

Q. And in Standard Smokeless?

A. Yes, sir. My brother is still mining, I am no longer partner now in Standard.

Q. And he is no longer partner in Far West?

A. That is right.

Q. Has Paragon Jewell ever made an effort to revise the agreement which you made with Mr. Grogan?

A. I believe in '58 Mr. Woods gave me a contract one time to read and I returned it to him the next day. We could not see where we could sign it.

Q. You refused to sign it?

A. Yes, sir.

Q. Other than that attempt, have they made any effort to revise the agreement?

A. Not to my knowledge.

Q. Did you hear Mr. Woods testify regarding this conference some eight or nine months ago when you and the Stilwells and the officials of Paragon Jewell met regarding some coal that lay between you?

A. About a certain instance that he was explaining that [fol. 1056] took shape, I believe, about some changes in the

underground direction of the work?

Q. That is right, when he said, I believe his testimony was that you and the Stilwells and he met to decide how a certain area of coal was to be mined?

A. Yes, sir, I believe I did.

Q. Do you recall that situation?

A. Yes.

Q. When did that occur, approximately?

A. I would say a little better than a year ago.

Q. Would you describe the circumstances of that?

A. Well, as I remember it, we thought we heard someone blasting underground and we went around to Stilwell's to see, look at their map, to see if we were maybe getting too close, because that is one thing we didn't want to do, because they employed several men underground, we had several men underground, and we did not want to cut our mine into theirs and disrupt their ventilation or have them disrupt ours. The result was we got around there and we couldn't see that we should not be that close. But what happened, what we call our Number 8 mine, we were up pretty close, almost drive up. And we were ready to start pulling pillars, but there was a block of coal to our right that the Stilwell boys said they couldn't get, they were up against a sandstone roll. Then the engineer, I believe Mr. [fol. 1057] Looney, his next time up, maybe the Stilwells had mentioned it to him, I won't say for sure, but maybe. we did, but anyway, he said, why don't you get this block of coal before you start pulling these pillars out. We said set the spads, and we will get it. Right where we were ready to start pulling back, we had maybe 30, 32 inches.

Q. Was that coal that was across the line under Stil-

well's-

A. (Interposing) Yes, sir, that would be on the right side of the line, of our line.

Q. Did you obtain the approval of the Stilwells before

you mined that coal?

A. Yes, sir, we talked to them about it, and they said they couldn't get it because they didn't want to get it, there was a roll. They had turned entries off to go into it. They run up against the sandstone roll.

Mr. Merrell: That is all.

Cross examination.

By Mr. Katz:

[fol. 1069] Q. I see. And surely, Mr. Merritt, you felt that [fol. 1070] if things didn't go the way you thought they ought to, that you could quit?

A. After I got my investment in there, I couldn't quit.

Q. Now, Mr. Merritt, it is true that according to your understanding of this contract, you had the right to terminate this contract at any time and so did Paragon Jewell?

A. Well, it was never discussed with me that way.

Q. I didn't ask you what was discussed, I said wasn't it your understanding that you had the right to terminate this agreement at any time and so did Paragon Jewell? Wasn't that your understanding?

A. No, sir, if it had of been, I wouldn't have went there

without some other understanding.

[fol. 1071] Q. Mr. Merritt, I will now hand you Petitioner's Exhibit for identification number 86 and ask you to state what that is.

A. This is a brief in the case of Kyva Mining Company.

Q. And it covers the years 1955 and '56?

A. 35 and 56.

Q. Now, I will ask you to look at the signature on that [fol. 1072] brief under the name "Kyva Mining Company" and will you tell me whose name that is?

A. That is mine.

Q. Did you sign this brief? .

A. I imagine I did.

Q. And as you can see, it was acknowledged on the 19th day of May 1958?

A. Yes.

Q. Is that correct?

A. That is right.

Q. And you, of course,-

A. (Interposing) Just a minute—

- Q. Yes. And you are, of course, familiar with what you put into this brief and what went into this brief, is that correct?
 - A. I am not.

Q. Well, where did the information come from that made up this brief? Who gave you this information?

A. Sir. I have no idea.

Q. You have no idea who gave the information to Mr. Stull that went into this brief?

A. I do not.

Q. Do you have any explanation as to where you signed this brief and had your signature acknowledged before a notary public?

[fol. 1073] A. I think I can.

Q. What is the explanation, sir?

A. In my memory, Mr. Earl Bowman came to my apartment one night in Grundy and told me he had this brief made up and as I remember it, he just said something not too much for me to worry about. I laid it right down on a little desk right there and signed my name to it, and took it downstairs to the lady to have it notarized and handed it back.

Q. Now, do you want the Court to understand you go around signing these briefs without reading and without knowing what they contain, sir?

A. Sir, I had confidence in the man at the time, and I signed several papers along about that time without read-

ing them.

Q. Well now, I refer you, Mr. Merritt, to page 6 of this contract at the—

The Court: (Interposing) Contract?

Mr. Katz: Of this brief, as it is entitled, Kyva Mining Brief, at the letter "I" and it states thereon, see if I am correct, "The contract specified the right of termination by either party at any time, but the question never arose between the partnership and Paragon."

Is that correct or not?

The Witness: The first time I ever read that was about [fol. 1074] three weeks ago.

By Mr. Katz:

- Q. Is it correct, that is all I am asking you?
- A. No, sir.
- Q. This is not a correct statement?

A. No, sir, that is not. Nothing like that was ever discussed between Mr. Grogan and I or Mr. Woods and I neither one.

Q. I am merely asking whether or not it was your understanding of the agreement as it states in your brief, that

the contract specified the right of termination by either party at any time, but that the question never arose between the partnership and Paragon!

A. Sir, as I told you before, I signed that, but I did

not read it.

Q. You signed it but do you deny that it is the truth, what I have just read?

A. Nothing like that was ever discussed with Mr. Grogan

and I that I know of.

Q. I just want one answer, was this a true statement or was it a false statement?

A. I didn't make that statement in there.

Q. Mr. Merritt, your name is signed to this statement.

A. I told you that I signed it.

[fol. 1075] Q. Well then, can you answer me this question, you admit that you signed it?

A. Yes, sir.

Q. You admit that it has this statement on here. Is that statement true or false?

A. I didn't make it.

The Court: Do you mean now?

The Witness: I didn't make it at any time.

The Court: He is asking you a question, I gather.

Mr. Katz: I want to know whether this is a true statement, whether it is his statement or not.

The Witness: No, sir, it isn't my statement.

By Mr. Katz:

Q. I know, Mr. Merritt, all I want you to tell me now is the statement, "The contract specified the right of termination by either party at any time." Is that true or false?

A. There was nothing in the verbal contract that we

ever discussed anything like that.

Q. Is the statement true or false?

A. I didn't make it.

The Court: He is making the statement to you now and asking you whether it is true or false.

The Witness: Oh, now-

The Court: (Interposing) I guess that is what you are

[fol. 1076] asking?

The Witness: Now I see what you mean. Sir, I don't see how I can answer whether it is true or false when I didn't make the statement and it was never discussed with me in any way, shape, form, or fashion like this.

By Mr. Katz:

Q. In other words, what you are saying is that the Persinger firm, Mr. Stull, made this statement up himself and put it in the brief and asked you to sign it?

A. Really I don't know where they got it.

- Q. Mr. Merritt, I now hand you Petitioner's Exhibit Number 87 for identification, which is a brief for the Standard Smokeless Coal Company, Grundy, Virginia, for the years 1954, '55, and '56. This brief was also to the Internal Revenue Service, is that correct?
 - A. Yes
- Q. I believe that the date of this brief is, which you signed, was May 19, 1958, is that correct?
 - A. Yes.
- Q. I will ask you whether or not you signed this brief, which was furnished to the Internal Revenue Service?
 - A. That is my signature.
 - Q: Was this one likewise prepared by Mr. Stull?
 - A. If it says it was, I guess it was.
- Q. Well, it was given to you and shows that Mr. Stull [fol. 1077] is the man that was the enrolled agent?
 - A. That is right.
- Q. Now, you will notice the affidavit which you signed on this brief, and it is the same as the other brief—

Mr. Merrell: (Interposing) Just a minute, I don't think he signed an affidavit. He signed the brief, but he didn't sign the affidavit. It is not signed under oath.

Mr. Katz: Your Honor, the affidavit says he appeared before the notary public and after being duly sworn, stated that he was one of the partners mentioned in the foregoing brief, that he has read the brief in its entirety and that to the best of his knowledge and belief, the statements made therein are true.

Mr. Merrell: But you said he signed that affidavit.

Mr. Katz: No, I am sorry, you signed the brief, and the affidavit was appended thereto with the words as I

have just read.

The Witness: As I recall it, when Mr. Bowman brought these papers in to me, he just came in like that, and told me, here is a brief, it was pretty late in the night. He told me about what they were for, which I didn't understand. And I put my name on them, I went downstairs and got my landlord, which is a CPA, and got her to notarize [fol. 1078] it. Honestly, I did not read it because I had confidence enough in the man to think that he had prepared them right.

By Mr. Katz:

- Q. How much schooling have you had, Mr. Merritt?
- A. About sixth grade; sir.

Q. And you can read?

- A. Oh, I can read and write.
- Q. You can write?
- A: Yes, sir.
- Q. And I will now ask you to refer to page 5 of Petitioner's Exhibit Number 87 for identification and under "I" in that brief, does it not state that the contract specified the right of termination by either party at any time but that the question has never arisen between the partners and Paragon, does it say that?

A. As I said before, sir, about three weeks ago was the

first time I ever saw that.

Q. You must have seen it when you submitted it.

A. No, I didn't read it.

[fol. 1079] Q. Well, I know you saw the paper, it was altogether for you to read?

A. Yes, but I didn't read it.

Q. Now, is that statement correct, true, or false, "The contract specified the right of termination by either party at any time"?

A. No, sir, not-

Q. (Interposing) That is false?

A. Not any contract talks that we have ever had, it was not true, because it wasn't discussed.

Q. You now say this statement is false?

A. As far as any dealing between Mr. Grogan and I, it is, I am very sorry to say.

Q. Is it false according to your understanding of what that agreement was and what it meant, Mr. Merritt?

A. I am sorry, I didn't get that.

Q. Isn't it true, Mr. Merritt, that not what each of you said, specifically what each of you said, but according to your understanding of what this agreement was, isn't it true that either party had the right to terminate at any time, just like you said it in here?

A. No, I didn't say it in there and I never was used to any contract like that, that either party walked off, and

that has never been mine just to walk off.

OFFERS IN EVIDENCE

Mr. Katz: At this time, your Honor, we would like to [fol. 1080] offer the briefs in evidence as Petitioner's Exhibits Numbers 86 and 87.

Mr. Merrell: I would like to inquire as to the purpose of them

The Court: What is the object?

Mr. Katz: The object is to discredit his testimony, your Honor, where he said there was no right to terminate. We say that he has stated that both parties did have the right of termination.

The Court: Only for impeachment purposes?

Mr. Katz: For impeachment purposes, yes, your Honor.

[fol. 1082] The Court: I will receive Petitioner's Exhibits 86 and 87 for the purposes of impeachment.

[fol. 1085] Q. Now you had no obligation, did you, Mr. Merritt, under the terms of your agreement, to go through rolls if you didn't want to go?

A. Yes.

Q. Yes what?

A. When we, when I talked to Mr. Grogan, he asked me if we were financially able to furnish an air compressor, air hammer, and necessary things to scale the top. As I told you before, in our Kyva mine, he wanted us to put in a mine like the Stilwell's, and we did buy this air compressor and jackhammer, air hammers, and we have gone through sandstone rolls.

Q. You have, but I said you were not under any obliga-

tion to go through them if you didn't want to?

The company, Paragon Jewell, could not force you to go through any roll if you came to a roll and said I am not going any further, could they?

[fol. 1086] A. When you talk about forcing, that is a dif-

ferent thing.

- Q. You know what I mean, they had no means of compelling you to go through a roll if you got to one, and then you decided you didn't want to go any further and you said you were going to come out, there was nothing they could do.
 - A. We never even did discuss anything like that.

Q. What is your understanding about it?

- A. I made preparations to go through these sandstone rolls. I wasn't figuring on backing out at the first one I came to.
- Q. Isn't that true in Kyva that is exactly what happened, you come to a roll and you didn't want to go through?

A. Kyva?

Q. Yes, sir.

A. No.

Q. That is the one you say mined out?

A. We mined it out.

Q. What you mean by mined out is that you hit a roll-

A. (Interposing) No.

Q. (Continuing) -And you didn't want to go through it? [fol. 1087] A. We mined it out, pulled the pillars back.

Q. You pulled the pillars back after you went to the

limit, that is to the roll that you came to-

A. (Interposing) No, there has never been a roll mentioned in Kyva. We went to the boundary.

Q. Show me the boundary you went through in Kyva. Show me the boundary.

A. Get the map, it isn't on there.

Q. Not on here?

A. I don't think. Get the map, I can show you. Better still, I believe I have a Kyva mined out map, show you exactly what is done. It is all right if I get it?

Mr. Katz: That is not in evidence.

The Witness: Sir, this is the beginning of the Kyva.

The Court: Does the-

Mr. Katz: (Interposing) I want you to show me on this map what you mean.

The Court: Can you show him on that map?

The Witness: We went up to here.

Mr. Katz: I have handed you Petitioner's Exhibit 81. .

The Witness: We bought, as I say, we bought this mine out, and after we bought him out, we drove up to here. [fol. 1088] Mr. Katz: Just a minute, where is the Kyva mine you are referring to?

The Witness: Number 6.

By Mr. Katz:

Q. And that is marked in ink with a large letter "K"?

A. Yes, sir.

Q. Number 6 Mine?

A. That is right. We drove these mines to here.

Q. You pointed to here (indicating)?

A. Right, to Number 8 Mine.

Q. To this point here?

A. Left a pillar there and pulled the pillar back.

The Court: The Number 7 Mine had been mined by somebody else before?

The Witness: Started by another party, we bought them out.

Mr. Katz: Who?

The Witness: Mr. Lester, and we went up to here and started pulling back out to here, and to this point here.

By. Mr. Katz:

Q. And you pulled all the pillars in this?

A. That is right.

Q. And you say you were still in good coal then when [fol. 1089] you found you had to stop, is that what you are telling this Court?

A. Kyva?

Q. Yes, sir, in Kyva.

- A. If we could have gone on through here, we would have been in the best of coal.
- Q. I am asking you this, and this is the answer I want, when you stopped mining at what you called your boundary, were you still in good coal?

A. I-Kyva was just getting into best coal up here.

Q. Were you at that point when you stopped mining, in good coal?

A. Yes, coal was good.

Q. Coal was good?

A. Coal was good.

Q. Did you not come to Mr. Woods—did you have a bad top condition in that mine?

A. No, we had a low top condition.

Q. It was a top that was such that you could not mine that coal?

A. It was low.

Q. It was too low to mine?

A. We mined it out.

Q. Could you go any further because of the low top?

[fol. 1090] A. We didn't have to-

Q. (Interposing) I asked you this, Mr. Merritt, did you stop going any further because of the low top?

A. We were at the end of our lease. Even with the low

top, we went ahead and finished it up.

A. Answer me this question, this is all I want. Did you stop mining because you had a low top?

A. No, I stopped mining because we were out of coal.

[fol. 1096] Redirect examination.

[fol. 1098]

By Mr. Merrell:

Q. With reference to the area of coal which you were operating, who was obligated to develop the mine?

A. We were.

[fol, 1099] By Mr. Merrell:

Q. You have testified with reference to the three operations that you had on property under Paragon lease, that there was a designated area which contained a certain [fol. 1100] amount of coal?

A. That is right.

Q. Did Paragon Jewell—I don't want to lead the witness.

Mr. Katz: We don't want you to, either.

By Mr. Merrell:

Q. Was any additions made to the coal area which you had?

A. Yes, sir.

Q. Was any of the area taken from you?

A. Never.

[fol. 1101] VIRGIL BOWLING was called as a witness on behalf of the petitioner [Merritt], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Merrell:

Q. During the years involved which is '54, '55, and '56, which of the partnerships are you interested in?

A. Kyva and Far West.

Q. Were you there at the time Kyva commenced operations on Paragon Jewell property?

A. Yes.

Q. Did you have occasion to discuss the agreement with Mr. Grogan?

A. No.

Q. You never discussed the agreement with Mr. Grogan?

A. No.

- Q. Were you an interested party in the Far West operation when it purchased the Meadows' operation?

 [fol. 1102] A. Yes.
- Q. At that time, did you examine the maps to ascertain the location of the Meadows' operation?

A. Yes, as a matter of fact, I examined the mines.

Q. Did you ascertain the area of the coal involved in that operation?

A. Yes.

Q. Did you hear Mr. Wesley Merritt, G. W. Merritt's testimony regarding the first map he received after the Meadows buy-out?

A. How was that?

Q. Were you present in the courtroom while Mr. G. W. Merritt was testifying?

A. Yes.

Q. And he testified that the Meadows' purchase was made in November 1956?

A. Yes, I would say, I don't remember the dates.

Q. Were you present when he testified regarding the first map that was submitted to you?

A, Yes.

Q. After you purchased the Meadows' operation?

A. Yes.

Q. And did that map cause you any concern when you saw it?

A. Yes, very much.

[fol. 1103] Q. Did you see the map?

A. Yes.

Q. What was the matter that concerned you?

A. Well, it cut off part of it. They drew a line across part of it.

Q. Part of what?

A. Part of the mines, I mean the projections that was on there, they had drawn a line across it.

Q. What was the result of that line insofar as area of that coal involved?

A. Shortened the life of the mines, it didn't go as far.

Q. What action did you take?

A. Well. I discussed it with my partner, Mr. Merritt.

Q. That is G. W. Merritt?

A. Yes.

Q. And did you talk to anyone from Paragon Jewell?

A. Not before I talked to him.

Q. After you talked to him?

A. No, not until the two of us was together and we talked to Mr. Woods.

Q. And what was the result of your conversation with Mr. Woods?

[A. Mr. Woods told us to disregard that line, that they [fol. 1104] shouldn't have put that on there, that we would go where we first started to go to.

Q. In other words, Mr. Woods told you that the map that was submitted to you was incorrect insofar as your area of

coal was concerned?

A. Yes.

Q. Mr. Bowling, are you still interested in the Far West Company?

A. Yes.

Q. Still mining coal on Paragon Jewell?

A. Yes.

Mr. Merrell: No further questions.

Cross examination.

By Mr. Gillespie:

[fol. 1105] Q. Did you, you had everything you made in your life put in the machinery to mine?

A. That is right.

Q. That is all you had, an investment?

A. That is all a fellow can put anything into that, that is about all he has.

Q. That is all you had money invested in was machinery

to mine with, wasn't it?

A. That, and about a year's work there before I got to run any coal.

[fol. 1106] Q. They paid you so much a ton for that coal on the Friday or Saturday following the time that you

dumped it in the tipple, didn't they?

A. They paid me like they did everybody else. When I put the coal over the scales, but if I didn't get it overthere, didn't get anything, regardless of whether I was running rock or what have you, I didn't get anything until it went over the scales.

[fol. 1109] Q. But you felt you did have to talk to him before you could get permission to acquire Mr. Meadows' mine?

A. Yes, before we could buy the lease.

Q. And the reason was you never acquired any interest in that coal out there in front of you and neither had Mr. Meadows, had he?

A. Yes, I think Mr. Meadows had put an awful lot into

that.

Q. What consideration had passed from Mr. Meadows to Paragon for any of that coal that was there still in the mountain unmined and byond his headings?

A. The development of the mines was worth a lot.

Q. What do you mean by development of the mine?

A. Well, when I went and looked at the mines, it was a very pretty mine, good coal heights and he had went [fol. 1110] through some pretty rough going.

Q. In other words, he was taking out the coal as he

drive his headings?

A. In some cases, he was taking out the rock.

Q. And he was just like your company, he knew that he would get paid for the coal as he took that out, but would not be paid for the rock when and if it appeared?

A. Yes.

Q. And all the coal that you or your company had mined from any of the Paragon leases has been delivered to Paragon's tipple?

A. We have had no occasion to take it any place else.

Q. You never had any right to take it any place else, did you, because it was Paragon's coal, wasn't it?

A. I don't know about that. I never tried to take it any

place else:

Q. And the only people that you looked to for your money was Paragon Jewell Coal Company, wasn't it?

A. When I put coal down there, I did.

Q. You didn't have to look any further for your money?

A. No.

Q. And it made no difference to you, when you dumped that coal in the fipple whether Paragon sold it for a profit or not!

A. Sure it made a difference to me whether they sold it [fol. 1111] for a profit or not because if they started selling it all at a non-profit, first thing you know they would be cutting the price of it.

[fol. 1125] James O. Watson was called as a witness on behalf of the petitioner [Merritt], and, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Merrell:

Q. Are you one of the petitioners in this case?

A. I am

Q. Which of the three partnerships involved did you have an interest in during the years involved?

A. I had an interest in Standard Smokeless Coal Com-

pany and Kyva Mining Company.

Q. When did your interest in those partnerships terminate, if you know?

A. February 28, 1956.

Q. Did you participate in any of the discussions with Mr. Grogan regarding the Standard Smokeless operation [fol. 1126] that commenced during the Fall of 1953?

A. Yes, I did. Mr. Lee Merritt made the first contact with Mr. Grogan and as he has so testified, and then Mr. G. W. Merritt and myself, went to Whitewood and saw Mr. Grogan and talked to him.

Q. Did you hear Mr. Wesley Merritt's testimony?

A. I did.

· Q. Did he answer truthfully regarding the terms of the agreement which you discussed with Mr. Grogan?

A. His understanding was the same as my understand-

ing.

Q. Did the agreement involve a designated area of coal?

A. It did.

Q. And what about the right of termination of the agreement?

A. That was not mentioned.

Q. Was anything discussed regarding the price which you were to receive for the coal that Standard Smokeless produced?

A. Yes, sir, price per ton was given to us.

Q. Was there any understanding regarding changes in that price?

. A. We were told it would go up and down according to

fluctuations in the market.

Q. At that time, were you discussing one or two opera-

[fol. 1127] tions?

A. We discussed first the Standard Smokeless, and then at the same visit, that we were interested in putting in a second operation.

Q. What was that second operation?

A. That was the Kyva Mining Company.

Q. Did you discuss the agreement governing the Kyva operation with Mr. Grogan?

A. Yes, we did.

Q. Were the terms of that agreement the same or different from those of the Standard Smokeless lease agreement which you just testified to?

A. They were the same.

Q. Were you there at the end of the year 1955?

A. I was.

Q. Were you acquainted with the financial status of Kyva at that time?

A. Yes, I was.

Q. Do you recall what it indebtedness was?

A. Our indebtedness at that time-

Mr. Gillespie: (Interposing) We object. What is the materiality, your Honor?

The Court: What is the purpose of this?

Mr. Merrell: I think it has a bearing on the question of the tenure of the agreement. I was going to show from [fol. 1128] this witness that they were substantially in debt and the only means that they felt they could recover this indebtedness was to produce the coal which they felt they had under lease.

The Court: Well, I can't—all right, you are objecting on the grounds of relevancy. I will overrule the objection.

The Witness: At the end of 1955, Kyva had been in operation slightly over a year. At that time our indebtedness was in the neighborhood of \$30,000.

By Mr. Merrell: .

Q. Were you there when they bought out the Sampy-Lester Mine or was that after your time?

A. That was after I left the operation.

Mr. Merrell: Nothing further.

Cross examination.

By Mr. Katz:

Q. Mr. Watson, as a matter of fact, you say you were in debt to about \$30,000, and you all went to Paragon and borrowed some money from them, didn't you?

A. No, sir.

Q. Never did?

A. Not while I was there, no, sir.

Q. Did Standard ever?

A. Not while I was with them, no, sir.

[fol. 1129] Q. Did any of these firms ever borrow any money from Paragon, Standard or Kyva?

A. After I left there, I have no knowledge.

Q. When did you leave?

A. February 28, 1955.

Q. Well, at the end of '55?

A. '56, excuse me.

Q. February 28, '561

A. Yes, sir.

Q. So at the end of '55 when you had this \$30,000 obligation, you pulled out yourself personally two months later, and you don't know where they got the money to continue on their operations, do you?

A. I have no knowledge of any financial transactions

after I left.

Q. After you left. Mr. Watson, what background and experience do you have in business before you came into this Standard and Kyva mines?

A. I had been in mining industry for 28 years.

Q. As a result, of course, you are familiar with mining contracts and agreements, et cetera, are you not?

A. Yes, sir, I am.

Q. You also know the solemnity of contracts and what they mean?

A. Yes, sir, I do.

[fol. 1130] Q. And you are very careful when you enter into negotiations for a contract as to what they will contain and what your obligations will be?

A. Yes, sir. When we first met Mr. Grogan, I asked

Mr. Grogan for a written contract.

Q. Just answer my question first, you are familiar?

A. Yes, sir.

Q. Now, Mr. Watson, as a good businessman, wouldn't it concern you very much to know what the termination arrangements would be with respect to a contract you were entering into?

A. It certainly would.

Q. And yet, you say that you all didn't discuss it?

A. We didn't discuss it.

Q. And you didn't bring it up?

A. No, sir.

Q. And you didn't know whether you would have to mine or not mine if you got into trouble there?

A. Well, I knew this, we had a certain boundary of coal which was given to us and told we could mine it out. If we had not had that assurance, we certainly would never have invested the sums of money that we did on the property.

[fol. 1133] Redirect examination.

By Mr. Merrell:

Q. I believe you testified that you were assured that you could mine this boundary of coal or you would not have gone into it?

A. We certainly would not.

Q. And if you had left the operation for some reason, is there any way you could have recovered the time, effort, and money that it took to develop the property?

A. No, that development, effort, and work and expense

would have been lost.

[fol. 1139] VIRGIL BOWLING was recalled as a witness on behalf of the petitioner [Merritt], and having been previously duly sworn, testified further as follows:

[fol. 1147]. Further cross examination.

[fol. 1148] By Mr. Gillespie:

STIPULATION

The Court: This is the stipulation, is it?

Mr. Gillespie: Yes. It has been stipulated that the entire purchase price of \$3500 paid by Kyva Mining Company to Sampey Lester has been added to the depreciable assets of Kyva Mining Company and the amount depreciated over a two year period.

Mr. Merrell: And segregated as \$1500 for equipment

and \$2,000 for mining rights.

The Court: Is that agreed upon by both parties?

Mr. Gillespie: Yes.

Mr. Merrell: That is agreed upon.

[fol. 1151] George G. Beall was called as a witness on behalf of the petitioner [Merritt], and having been first duly sworn, was examined and testified as follows:

· Direct examination.

By Mr. Merrell:

Q. Mr. Beall, a stipulation shows that you are a partner in the Sally Mining Company and the other partner is [fol. 1152] Mr. Lloyd Conley. What is the Sally Mining Company doing at the present time?

A. Sally Mining Company is mining coal on what is

called number two lease of Paragon Jewel property.

Q. How long have they been mining coal on that property?

A. Been mining coal since August, 1955.

- Q. Before Sally Mining Company started mining on this property did you have any discussions with officials of Paragon Jewel regarding the operation?
 - A. Before we went on the property to mine?

Q. Yes. A. I did.

Q. With whom did you discuss it?

A. With Mr. C. A. Clyborne.

Q. And would you tell us what transpired during those discussions?

A. This was a telephone conversation after I had contracted to buy the equipment from Stone and Blankenship.

Q. Were Stone and Blankenship operating on the property at that time?

A. That was my understanding.

Q. And had you had any discussions with Stone and Blankenship regarding the operation?

A. Only as pertaining to the purchase of the equipment [fol. 1153] thereon and what they were doing there, yes.

Q. Why did you contact Mr. Clyborne?

A. After I contracted to buy the equipment which was already there serving the purpose of mining I wanted to get clearance and approval from the authority of Paragon Jewel. I had met Mr. Clyborne many years before, I didn't think he remembered me, and I called him up. I think it was the night that I made a temporary contract to buy the equipment.

Q. Did Mr. Clyborne or Paragon Jewel have any interest

in the equipment?

A. Yes, they did.

Q. What was the nature of that interest, if you know?

A. They had a first mortgage on the equipment.

Q. And did you reach some agreement with Mr. Clyborne?

A. I did.

Q. What was that agreement?

A. The agreement was that after I had informed him that I would pay cash for Stone and Blankenship's equity I would also pay cash to clear the mortgage. He approved of that plan and was very cordial in having us succeed Stone and Blankenship for the purpose of going on the property and mining the rest of what the lease entailed.

Q. During the course of that conversation what, if anything, was said by either you or Mr. Clyborne regarding the right of either party to terminate the agreement for

[fol. 1154] mining coal?

A. There was nothing said to the best of my recollection.

Q. Was anything said regarding the question, by either party, of who would be entitled to claim depletion?

A. No, sir, the word "depletion" was not mentioned.

Q. Did you ever discuss the agreement with Mr. Woods?

A. No, sir, I didn't know Mr. Woods at the time at all. I had never met him. I had never known him. My one contact was the telephone conversation with Mr. Clyborne. It was several weeks or months after before I ever met Mr. Woods.

[fol. 1167] SHERMAN MEADOWS was called as a witness on behalf of the petitioner [Merritt]; and having been first duly sworn, was examined and testified as follows:

Direct examination.

Q. Mr. Meadows, it has been stipulated that you were the owner of the Meadows Coal Company.

A. Yes, sir.

Q. As I understand it, it mined coal on property that Paragon Jewel had leased beginning in 1954?

A. Yes, sir.

Q. Do you recall when you started mining on the property?

A. When I started mining on the property?

Q. Yes.

[fol. 1168] A. I can't think exactly the date on that that I started running coal, but I started some time in March, it seems to me, in '54.

Q. Prior to starting your operations did you discuss the matter with any officials of the Paragon Jewel, with any

person representing Paragon Jewel?

A. Yes, sir, when I went there and leased the coal I

talked to Mr. Grogan.

Q. Now, Mr. Meadows, will you tell us what transpired during your discussions with Mr. Grogan?

A. Well, he laid me off a boundary of coal.

Q. What do you mean by laid you off a boundary of coal?

A. Well, sir, when I first went there I asked him about a mine and I told him I wanted a place to put in two mines close together where I could switch my equipment from one mine to another mine, and he said he only had one place like that and he doubted whether I was financially to put that operation in or not.

Q. Doubted whether you were—

A. Financially able to put those mines in the way they would have to be put in to get the coal.

Q. Did he agree to give you an operation consisting of two mines?

A. So I talked on with him. Later he decided—he and I went out on the surface and he showed me how large a [fol. 1169] boundary of coal at which I was supposed to mine.

Q. He showed you on the surface of the land, is that

what you are referring to, Mr. Meadows?

A. Yes, sir. Now that is the front of it, didn't go all the way around or anything like that.

Q. Did he show you in any other manner the area which

you were to mine?

A. Well, he had a map of the property, big map, and he showed me on the map. That was before that we went out to the property and looked at the mine.

Q. After you commenced mining operations were you

given any mining maps?

A. After?

Q. After you started your operation?

A. Yes, sir.

Q. Did these maps indicate anything with reference to the boundary of coal?

A. Yes, sir, they did.

Q. Now what was your obligation with reference to the coal within the area that had been designated to you?

A. Didn't quite understand you, sir.

Q. What was your responsibility or obligation with reference to the coal in the area designated to you?

A. Well; in other words, I had a boundary of coal.

Q. What were you to do with that coal? : [fol. 1170] A. I was to mine that coal and take it to a preparation plant.

Q. How much of it were you to mine?

A. All the coal that I could mine. .

Q. Was anybody else given the right to mine in that area?

A. No, sir.

Q. How long could you continue to mine the coal in that area?

A. I started mining coal there in '54 and I sold out there in '56.

By Mr. Merrell:

Q. What, if anything, was said between you and Mr. Grogan as to the right of anyone to terminate your agree[fol. 1171] ment to mine this coal?

A. Was there anything? My agreement was to mine that coal under state and federal mining laws. I had that bound-

ary of coal to mine.

Q. Was it your understanding that you could mine it to exhaustion?

A. Yes, sir.

Q. Was there anything said regarding any buildings that

you would place on the mine premises?

A. Yes, sir, he told me if something happened I couldn't mine that coal I couldn't take any buildings or any tipples down under the lease which the company had.

Q. Did you ever borrow any money from Paragon Jewel?

A. No, sir. .

Q. How many shifts did you run when you started operating in '54?

A. How many shifts?

Q. Yes.

A. Well, we run two shifts part of the time.

Q. When you started mining did you have any planned

tonnage which you sought to obtain per day?

A. Well, I would say there over about something like a year we got up to around 300 tons, somewhere along there.

I wouldn't say definitely.

Q. Why did you want to get up to 300 tons per day if you

[fol. 1172] could?

A. Well, we had to do that in order to take care of the overhead and expense and cost.

Q. What do you mean by overhead and cost?

A. In other words, the cost to the mines.

Q. And the cost of operating?

A. That's right.

Q. What about the cost of installation of mine?

A. Well, that includes what I mean.

Q. Mr. Meadows, was there any agreement at this time you commenced mining operations as to the engineering services?

A. Yes, sir.

Q. What was that agreement?

A. Well, the agreement was that the company would furnish an engineer but I had to pay him.

Q. What did you do for power at your mine, electrical

power?

A. Well, the company had a line, a power line that come in there, and we attached on that, and they charged meright off I just don't remember how much it was a ton until I could check back on the books.

Q. You bought company power at a tonnage rate?

A. Sir?

Q. You bought the company power at a tonnage rate?

A. Yes, pretty sure that's right. But anyway it is on that [fol. 1173]—I had a record of it.

Q. Mr. Meadows, could I ask you how much education you have had?

A. Oh, I haven't-I had third grade, was as far as I got.

Q. So far as you got was the third grade?

A. Yes, sir.

Q. I believe you testified you sold your operation towell to whom did you sell it?

A. I sold it to Lee Merritt, Wesley Merritt, Virgil

Bowling:

Q. I show you Petitioner's Exhibit 84, directing your attention to page 2 thereof. Does your signature appear thereon?

A. Yes, sir.

Q. Are you able to ascertain from this document what it is, Mr. Meadows?

A. Yes, sir, that is the coal mine and also the equipment.

Q. Is that the agreement that you executed with the Merritt interest?

A. Yes, sir.

Cross examination. [fol. 1175]

By Mr. Gillespie:

Q. Mr. Meadows, you say that Mr. Grogan took you out on the ground and showed you an area of coal that he wanted you to mine?

A. Yes, sif.

- Q. Now, did he tell you that he wanted you to mine coal and deliver it to Paragon's tipple?
 - A. Yes, sir, he did. Q. And he said he would pay you so much a ton for doing

[fol. 1176] that work. That is a fact, isn't it?

A. He told me when I went there that he would—the

price would be based on the market price.

Q. Didn't he tell you what the price that he was paying for mining and delivering that coal to Paragon's tipple was at that time?

A. Yes, sir.

Q. Do you recall what it was?

A. At that particular time?

Q. Yes.

A. Definitely I couldn't answer that right now.

Q. But it was a fixed sum per ton and that was your compensation for mining and delivering that coal to the tipple, wasn't it? That was what Paragon was going to pay you for it?

A. At that time, but the price was supposed to change

according to the market price; it would vary.

Q. Well, whatever the price was, whether it went up or down, but that was what you were getting paid to do, wasn't

A. Yes, sir.

Q. And you never agreed to pay Paragon anything for

any unmined coal, did you Mr. Meadows?

A. Well, sir, my understanding was when I went there I had coal and I was supposed to mine that coal and take it to their preparation plant.

Q. That's right, and you say that nothing was said-

[fol. 1177] strike that please.

You say that you don't remember anything being said about termination?

A. In other words, I was supposed to mine the bound-

aries of the coal.

Q. I don't believe you understood my question.

In answer to a question asked you by Mr. Merrell, you said that nothing was said about your right to stop mining or the Paragon Jewel Coal Company's right to stop you from mining.

Did you understand the question, Mr. Meadows?

A. Repeat that again. I am hard of hearing.

Q. Perhaps I sould stand up. Maybe that is the trouble.

I believe you have testified that you didn't recall anything being said either by you or Mr. Grogan when you were talking to him about doing this mining there, about terminating the contract. Is that right?

A. Well, he told me that I had that boundary of coal as long as I mined it according to the State and Federal mining laws, but I couldn't go in there and mine just all the

coal out, and he made that clear.

Q. He told you you couldn't go in and just mine in any way, any way that you wanted to, but you had to mine in accordance with State and Federal mining laws and in such manner as may be projected by an engineer which they [fol. 1178] would select, and which you would have to pay for?

A. Right.

Q. And that they were interested in recovering the greatest amount of coal from their lands that was possible?

A. Yes, sir.

Q. Now, did you discuss anything about whether you could quit any time you wanted to, or whether Paragon could terminate your services any time they wanted to?

A. No, sir. In other words, I was supposed to go ahead and mine that coal out, previding I mined it according to

the State and Federal laws. .

Q. Well, Mr. Meadows, now if you were supposed to mine it all out, why did Mr. Grogan tell you that in case you couldn't mine it, you would have to leave any buildings on the land?

A. Well; there was something could have happened to me; many different things could have happened to me during that time.

Q You could have pulled out or you could have stopped

for various reasons, couldn't you?

A. No. In other words, if I drove it in there, and he had stopped me for not driving to the State mining laws, and he stopped me, I couldn't have taken the equipment with me.

Q. And if you started mining in such manner as would [fol. 1179] have resulted in what is termed hogging the

coal, he would have stopped you, wouldn't he?

A. Sure. If I was going to mine not lawfully and so forth, he probably could have stopped me. Any lease I have ever had was that way.

Q. In other words, Paragon had an engineer that was going to do all the inside engineering work for all of the mines on their property, didn't they?

A. I don't know anything about any of the mines except-

ing mine because I never fooled with any of them.,

Q. Well, he told you that they would select the engineer to make these projections for you to mine, but that you would have to pay them so much a ton, and that was part of the deal?

A. Yes, sir,

Q. Now you further say he said, that if something happened that I couldn't mine, that I couldn't take any of the buildings off the land.

That is what he told you, wasn't it?

A. Anyway, I wasn't supposed to remove any buildings.

Q. Now was there anything else that Mr. Grogan told you that imposed any obligation whatsoever upon you in case you couldn't mine the coal for any reason?

A. Well, he didn't tell me that there wasn't-he didn't

tell me he wasn't holding me responsible for it.

[fol. 1180] Q. But the only thing that he told you was that you couldn't remove any buildings. So far as you know, you had been under no obligation to pay Paragon anything or the land owners anything whatsoever in case you couldn't mine the coal. That is right, isn't it?

A. I don't know what would have happened there; it's

just according to how it would have come about.

Q. You never agreed to assume any other obligation, did you, Mr. Meadows! If you had, you would have known what they were, wouldn't you!

A. I don't quite get you.

Q. You never agreed with Mr. Grogan to assume any obligation to Paragon or any other person in case you failed to mine or were unable to mine the coal underlying its land. If you had agreed to make any payment or assume any other obligation whatsoever, you would know

what it was, wouldn't you?

A. Well, I was obligated there to pay for the equipment and the power and the engineer, and I paid for the lumber and all of my tools, metal and so forth, that I invested on the property, and if I had the least bit idea that they could run me off over night, I wouldn't have invested my money there, if that is what you are getting to. Because that is the first lease I ever had that I didn't have a written lease. I made three or four trips up to see Mr. Grogan before I accepted the lease, for the reason I didn't get a written lease [fol. 1181] on it, because that is only the first one.

[fol. 1182] Redirect examination.

By Mr. Merrell:

- Q. Were you a licensed mine operator when you were working here, Mr. Meadows?
 - A. Sir?
 - Q. Were you licensed by the State of Virginia?

A. Yes, sir.

Q. What does the mine inspector do if you don't mine property?

A. Close you down.

[fol. 1183] Q. Did he inspect your mines from time to time?

A. Yes, sir.

Q. Who did he hold responsible for your operations?

A. He held me responsible.

LLOYD CONLEY was called as a witness on behalf of the petitioner [Merritt] and, having been first duly sworn, testified as follows:

[fol. 1184] Direct examination.

By Mr. Merrell:

Q. Mr. Conley, it has been testified by your partner in the mining company that you commenced mining operations on property which Paragon had under lease in August, 1955. Is that correct?

A. Yes, sir.

[fol. 1185] Q. Did you contact any official of Paragon Jewel to determine—who determined the terms of the agreement under which you were to move to the property?

A. Yes, sir, I talked to Mr. Woods. Q. Where did you talk to Mr. Woods?

A. Down at the mining office, there at his office he had there at the tipple.

Q. Was this before you went onto the job?

A. Yes, sir, before we went.

Q. Would you tell me what Mr. Woods told you, advised

you regarding the operation?

A. Yes, sir. He told me that there we would be—all that was required down there, he said for us to mine according to the state mine laws and the federal laws, and that there would be—I believe it was three cents a ton for the engineering, five cents a ton for road, and 12½ cents a ton for the power, and 2½ per ton for rejects. That would be cut out of the price of the coal.

[fol. 1186] Q. Now you and—did you and Mr. Woods discuss any area of coal that would be involved in your

operation!

A. No, sir. we didn't. He just told me—I just told him we were taking over the lease, and I presumed that those maps that were up there at the mines was the coal that we were supposed to mine, and later on, I thought we was running out of area to work, and I went down and talked to

Mr. Woods, and he got out the big map that they have there and showed me the area which we had still to go on, which we would have had—if we hadn't ran into some rolls we would have around ten years' work there or longer.

Q. What did he say to you with reference to this area

of coal that was shown to you on the map?

A. He just said that we had plenty of coal to mine there, and that was all that was ever said.

Q. Was anything ever said to you regarding the termination of the agreement or the right to terminate?

A. No. sir.

Q. Was anything ever said regarding the right to claim

depletion?

A. No, sir, I never heard anything about depletion until [fol. 1187] 1956. That was the first I heard anything about any depletion or knowed anything about any depletion.

Q. Why were you willing to enter into that agreement

with Paragon Jewel?

A. I don't quite understand.

Q. The agreement to take over this operation?

A. Well, we seen that there was a good territory of coal there, and we wanted somewhere where we could settle down and stay and not just be going from place to place to work.

Q. What did Mr. Woods advise you regarding what was

to be done with the coal after you mined it?

A. Well, either we was to bring it down to their tipple and dump it—

Q. You were to be paid on what basis?

A. By the ton, so much per ton for delivering it down there, all the coal, the coal that could be used.

Q. If you did not deliver any coal to Paragon, what claim did you have against them for any compensation?

A. Not anything.

Q. Was anything said to you regarding the price that you would be paid for your coal?

A. No, there was not; what it was paid per ton.

Q. Was there anything said regarding possible changes in the price?

A. No, there wasn't anything as I recall.

[fol. 1188] Q. Has the price that you received changed during your tenure?

A. Yes, it has, it has gone up and gone down.

Q. Do you know the reason for the change?

A. No, sir, I don't. It was told that they couldn't sell their coal, that they had to compete in price with others around there.

Q. Now let's see, you mean when your price went down,

what would they say again?

. A. Well, it was the understanding that they had competitors there that they had to compete prices with in order for us to operate.

Q. Are you still mining on Paragon Jewel's leased prop-

erty!

A. Yes, sir.

Q. Under your agreement as you understood it, who was obligated to develop the mine and produce the coal?

A. We were.

Q. Has Paragon Jewel always taken all the coal you could produce?

A. Yes.

Cross examination.

By Mr. Gillespie:

[fol. 1192] Q. Have you or Mr. Beale ever paid or agreed to pay Paragon Jewel Coal Company for any of the coal which was still under that mountain and unmined at the time you went in there?

A. Didn't have any cause to.

Q. You have no property interest whatsoever in any

[fol: 1193] of the coal that was unmined?

A. Well, I don't know, we just had a lease up there, and I don't know whether I owned it or didn't own it. I figured the coal was there for me to mine, and that is all I know. I can't answer your question on that just the way you would like for me to, because I don't know.

[fol. 1243] Frank H. Woods was called as a witness on behalf of the Petitioner [Paragon] and, having been previously duly sworn, testified further as follows:

[fol. 1244] Direct examination.

By Mr. Katz:

Q. Mr. Woods, both Mr. Merritts have testified that when they started in the operation of the Standard Smokeless Coal Company that they had a map and that they were pointed out a specific boundary of an area of coal which

they could mine to exhaustion.

Now, at the time Standard Smokeless came up to go into operation, I will ask you whether or not Petitioner's Exhibit 75 was then the only map that would show the development of the Brown Heirs' No. 1 tract, which is the tract where Standard Smokeless went?

A. Yes, sir, this is the most recent map we had at that

time.

· Q. And what was the date of that map again to

A. August 15, '53.

Q. Do you remember when Standard Smokeless of the

Merritt group started in their operations?

A. I have the date—sometime after that; shortly after that.

The Court: What exhibit number is that?

Mr. Katz: Seventy-five.

By. Mr. Katz:

'Q. Now, Mr. Woods, will you explain to the Court whether or not the Merritts could, based upon the informa[fol. 1245] tion then available, have been given a specific area of coal to mine to exhaustion?

A. No, sir.

[fol. 1246] Q. All right, now continue.

A. This property extends over a mile and a quarter to a mile and a half in this direction, which shows on the back

[fol. 1247] of the map, which you could see if this map were folded up on the wall.

The Court: "In this direction" means the top of the map? The Witness: Yes, sir, extending from the crop line to the top of the map it is possibly a mile and a quarter or a mile and a half to where it comes out on the other end.

These mines were all driving in the same general area as that mine. We knew later on we would have other mines driving into the same general area, and we did not lay off any specific area of coal to mine because it has already been shows that some of these fellows over here quit. When they start we have no way of predetermining how much equipment the man is going to buy; or they say, we want to run 200, 300 tons of coal a day, but until they have proven themselves, we just don't know how far they are going, and their projections are set up like these are here, and as he develops if he buys more equipment and so forth to mine more coal, then we give them a different—add to the amount of coal they get to mine there.

But on this property—altogether on this property we have had 10 or 11 openings and only three of those openings have mined nearly to the center of the property as we had it projected. We have to recover on this lease 85 per

cent or more of the merchantable coal.

Well, we have this property, the Stilwell property, the [fol. 1248] property at the back of here, what we refer to as our Binney's Branch property. All of that has to be coordinated; that is the reason we have one engineer to do the work.

By Mr. Katz:

Q. You said Stilwell property-

A. Stilwell mine; I meant McNally property on which

Stilwell started his mining operation.

We cannot predetermine when these men start out whether they will go 10,050 feet or 290 feet. It is impossible for us to do it the way we have to project our overall pattern of the mines.

39 T. C. No. 22

Before the Tax Court of the United States

Docket Nos. 84122-84126, 90765, 90766

ROBERT LEE MERRITT and WINNIE MERRITT, et al., Petitioners,

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Opinion—Filed October 31, 1962

- 1. Petitioner Clyborne acquired leases on coal properties and assigned them to petitioner Paragon, of which he was controlling stockholder, for overriding royalties. Respondent disallowed all or a part of the overriding royalties as deduction to Paragon and taxed them as ordinary income to Clyborne. Held: 25 cents per ton of the 30-cent-per-ton royalty paid by Paragon to Clyborne was in fact a royalty, reasonable in amount, and is deductible by Paragon as an ordinary and necessary business expense, and the difference between 25 cents per ton and the royalties and overriding royalties paid by Clyborne to others is taxable to Clyborne as capital gain under section 631(c), I.R.C. [fol. 1274] 1954. The remaining 5 cent per ton paid by Paragon to Clyborne represents a nondeductible distribution by Paragon, taxable as a dividend to Clyborne.
- 2. Paragon entered into oral contracts with petitioners Merritts, Bowling, and Watson under which the individual petitioners mined coal from properties under lease to Paragon and delivered it to Paragon's tipple and cleaning plant, for which they were paid a fixed amount per ton by Paragon. Held: The individual petitioners did not acquire an economic interest in the coal in place and are not entitled

Proceedings of the following petitioners are consolidated herewith: G. Wesley Merritt and Fannie J. Merritt, Docket No. 84123; Jack D. Merritt and Willa Gray Merritt, Docket No. 84124; Virgil Bowling and Gladys Bowling, Docket No. 84125; James O. Watson 3d and Lucy J. Watson, Docket No. 84126; C. A. Clyborne and Vernice H. Clyborne, Docket No. 90765; and Paragon Jewel Coal Company, Incorporated, Docket No. 90766.

to deduct depletion on the amounts they were paid by Paragon under the oral contracts. Paragon is entitled to deduct percentage depletion on its gross income from the property, less royalties paid, undiminished by the amounts it paid the contractors.

John Y. Merrell, Esq., for the petitioners in Docket Nos. 84122, 84123, 84124, 84125, and 84126.

LeRoy Katz, Esq., Carl C. Gillespie, Esq., and Frederick Bernays Wiener, Esq., for the petitioners in Docket Nos. 90765 and 90766.

Bart A. Brown, Jr., Esq., for the respondent.

DRENNEN, Judge: In these consolidated proceedings respondent originally determined deficiencies in income tax and additions thereto due from petitioners as follows:

[fol. 1275]

		Deficiencies					
Docket No.	Petitioner	Year	Income Tax	Additions I.R.C. 193 294(d) (1) (A)	39, Secs.		
84122		1954	\$ 848.48	\$208.50	\$135.24		
OTIZZ	and Winnie Merritt	1955	1,532.21	- /	/s -		
	the William Indiana	1956	3,373.52	_	· 		
84123	G. Wesley Merritt	1954	886.88	231.58	125.18		
	and Fannie J.	1955	1,596.52	.,	1 77		
	Merritt	1956	3,317.39		1)-		
84124	Jack D. Merritt and Willa Gray Merritt	1956	3,531.81		· -		
84125	Virgil Bowling and Gladys Bowling	1955 1956	90.18 3,342.48	- 2	=		
84126	James O. Watson 3d and Lucy J. Watson	1954 1955	876.83 1,975.05	Ξ.	_		
90765	C. A. Clyborne and	1955 1956	16,907.02 23,449.76		· ·		
	and Vernice H. Clyborne	1957	27,551.33	: ;E	7		
		rable ye ed Sept,			/.		
90766	Paragon Jewel	1955	2,529.29				
, 50.00	Coal Company,	1956	36,588.04	7	_		
×	Incorporated	1957	57,021.20	· · ·	_		
	/						

In addition, by amendment to answer² respondent has asserted claims for increased deficiencies, over and above those set forth above, in income tax as follows:

Docket	No.	Petitioner		Year	Deficiency
90765		A. Clyborne and ernice H. Clyborne	×	1955 1956 1957	\$8,356.13 6,936.34 9,015,27

Taxable year ended Sept. 30;

	1	•	chaca sept. ou,	
90766	Paragon Jewel Company, Incor		1955 1 1956 1957	5,434.51 5,711.56 6,481.32

[fol. 1276] Petitioner in Docket No. 90766 has made claim for overpayment for the taxable year ended September 30, 1955, in the amount of \$6,307.24.

The issues remaining for decision in Docket No. 90766 are:

- 1. Whether Paragon Jewel Coal Company, Incorporated (hereafter called Paragon), is entitled to deduct as royalties in each of its taxable years here involved, amounts paid to C, A. Clyborne (hereafter called Clyborne), or whether such amounts constituted nondeductible distributions of earnings and profits of Paragon.
- a. The correlative issue of whether such amounts are taxable to Clyborne as royalties, as reported by Clyborne, or as dividends as claimed by respondent, is the only remaining issue in Docket No. 90765.
- 2. Whether Paragon is entitled to the deduction for percentage depletion with respect to its entire gross income from coal mined under contract by Standard Smokeless Coal Company, Kyva Mining Company, Farwest Coal Company, Bare Ridge Coal Company, Sally Mining Company,

² Although respondent in Docket Nos. 90765 and 90766 filed second amendments to answers, no increased deficiencies were therein asserted.

and Meadows Coal Company (hereafter called, respectively,, Standard, Kyva, Farwest, Bare Ridge, Sally, and Meadows, or referred to individually or collectively as contractor or contractors), less royalties paid; or whether Paragon's "gross income from mining," for purposes of computing the deduction for percentage depletion is to be reduced by the amounts paid these contractors.

a. The correlative issue of whether certain of the contractors, Standard, Kyva, and Farwest, are entitled to deductions for percentage depletion with respect to amounts paid them by Paragon is the only remaining issue in Docket Nos. 84122, 84123, 84124, 84125, and 84126, the male petifol. 1277] tioners in those docket numbers having been partners in one or more of those firms. The other contractors mentioned above are not parties in this proceeding.

For convenience the two principal issues will be referred to, respectively, as the "royalty issue" and the "depletion issue." Petitioners in Docket Nos. 84122-84126 are not involved in the royalty issue and respondent has taken a neutral position with respect to the depletion issue, agreeing at the trial that either Paragon or the contractors are entitled to depletion on the amounts paid by Paragon to the contractors, but not both.

General Findings of Fact.

Some of the facts have been stipulated and are found.

accordingly.

Petitioners in Docket No. 84122 are Robert Lee Merritt (hereafter called Lee) and Winnie Merritt, husband and wife, who resided in Grundy, Virginia, during the period here involved, and who filed joint Federal income tax returns for the calendar years 1954, 1955, and 1956 with the district director of internal revenue, Richmond, Virgin a.

Petitioners in Docket No. 84123 are G. Wesley Merritt. (hereafter called Wesley) and Fannie J. Merritt, husband and wife, who resided in Louisa, Kentucky, during the period here involved, and who filed joint Federal income tax returns for the calendar years 1954, 1955, and 1956 with the district director of internal revenue, Louisville, Kentucky.

Petitioners in Docket No. 84124 are Jack D. Merritt (hereafter called Jack) and Willa G. Merritt, husband and wife, who resided in Grundy, Virginia, during the period here involved, and who filed a joint Federal income tax [fol. 1278] return for the calendar year 1956 with the district director of internal revenue, Richmond, Virginia.

Petitioners in Docket No. 84125 are Virgil Bowling (hereafter called Bowling) and Gladys Bowling, husband and wife, who resided in Grundy, Virginia, during the period here involved, and who filed joint Federal income tax returns for the calendar years 1955 and 1956 with the district

director of internal revenue, Richmond, Virginia.

Petitioners in Docket No. 84126 are James O. Watson 3d (hereafter called Watson) and Lucy J. Watson, husband and wife, who resided in Louisa, Kentucky, during the period here involved, and who filed joint Federal income tax returns for the calendar years 1954 and 1955 with the district director of internal revenue, Louisville, Kentucky.

Petitioners in Docket No. 90765 are C. A. Clyborne and Vernice Hy Clyborne, husband and wife, who resided in Bluefield, West Virginia, during the period here involved, and who filed joint Federal income tax returns for the calendar years 1955, 1956, and 1957 with the district director of internal revenue, Parkersburg, West Virginia.

Petitioner in Docket No. 90766 is Paragon Jewel Coal Company, Incorporated, a corporation organized under the laws of Virginia on October 22, 1951, and having its principal business office in Bluefield, West Virginia. It filed a Federal income tax return and an amended return for the taxable year ended September 30, 1955, and Federal income tax returns for the taxable years ended September 30, 1956 and 1957, with the district director of internal revenue, Richmond, Virginia.

[fol. 1279]

1. Royalty Issue.

Findings of Fact.

Clyborne moved to Bluefield, West Virginia, in 1918 as district manager for a corporation engaged in the business of acting as sales agent for coal and coke companies. He

worked for the same employer, or for employers engaged in the same business, until 1929 when the corporation for which he was working discontinued business. During this period his experience in coal production was limited to acting as manager of a small operation in Virginia. In the 1930's he entered into a coal sales contract with a sales company in Baltimore, Maryland, which was also a whole-saler of coal and coke. He organized a corporation, Clyborne, Incorporated, to act as agent for the sales company, which it still does. In this work Clyborne became familiar with the coal fields of southern West Virginia and of south-

western Virginia.

In about 1944 or 1945, J. H. Franks (hereafter called Franks), who had been in the coal-mining business in Russell. Tazewell, and Buchanan Counties in Virginia for a number of years, approached Clyborne for financial assistance in "blocking up leases" of coal properties in the Whitewood or Dismal River section of Buchanan County. Virginia. In order to justify the necessary investment for a substantial mining operation it is necessary to obtain leasehold interests, or some interest in the coal in place in a large area of land. This often entails obtaining mining leases, or title to the minerals, from the owners of several (or, perhaps many) contiguous tracts of land containing the seam which is to be mined. Also involved is the acquisition of rights to bring mined coal over or through land [fol: 1280] which lies between the point of a proposed mining operation and the point where the mined coal is to be processed and loaded. This practice of obtaining leaseholds or title to the minerals and wheelage rights is called "blocking up leases" and might be done by an individual on his own behalf or as an agent for an operating company. It is a practice which has been prevalent in Buchanan County .. for a number of years and in the Whitewood area since a railroad was built along Dismal River in the 1930's.

Franks had acquired options to lease the minerals underlying a part of the Cole heirs' tract on Laurel Fork of Dismal River above Whitewood. Clyborne was generally familiar with the seams of coal underlying that area and

was particularly interested in the Raven, or Jewell, seam' which was known to be found in the area. The Jewell seam produces a relatively low volatile bituminous coal which has low sulphur and low ash content and good coking structure, and hence is saitable for the high priced metallurgical coal market. However, the Jewell seam in this area was unpredictable, containing numerous faults and pinching out entirely in places, and was quite thin, ranging on the average between 24 and 32 inches. Prior to 1950 the only major coal operator in the area was Jewell Ridge Coal Corporation, which had acquired the mineral rights on a large part of the coal lands in the general area. Also, prior to World War II, equipment had not been available to [fol. 1281] mine such a thin seam of coal at a profit. But with the advent of the railroad up Dismal River, improved mining equipment, and the demand for metallurgical grade coal. Clyborne felt that coal from the Jewell seam in the Whitewood area might be mined and sold at a rofit. Consequently, he entered into an arrangement with Franks whereby Clyborne would put up the necessary capital to acquire the leases, which would be taken in the names of Franks and Clyborne, and Franks' one-half share of the capital investment would be repaid to Clyborne out of Franks' share of royalties received from the coal.

This relationship, with variations and minor exceptions, continued until about 1952 when Clyborne began acquiring leases directly in his own name. As hereinafter detailed in our findings of fact on the depletion issue, Clyborne, d.b.a. Paragon Jewel Coal Company, began construction of a coal tipple and cleaning plant on the McNeil tract in January 1951 which was completed on or after October 22, 1951. On October 22, 1951, Clyborne formed Paragon Jewel Coal Company, Incorporated, for the purpose of mining, through independent contractors, processing, and selling the coal mined from the leases referred to above.

Testimony indicates that "Raven" or "Raven Red Ash" are the names for the seam used generally. "Jewell" is the name used locally? Sometimes the name "Jewell Ridge" is used. See findings with reference to the Brown heirs' No. 2 tract.

and transferred the tipple and cleaning plant to the corporation. Clyborne and his wife were the sole stockholders of the corporation when it was formed and Clyborne continued to be the principal and controlling stockholder, and principal officer, of the corporation throughout the years here involved.

After the corporation was formed Clyborne from time to time assigned leases held in his name to Paragon for a royalty of 30 cents per ton. The corporation assumed responsibility for Clyborne's liabilities under these leases, but [fol. 1282] in most instances the landowners were not parties to the assignment and Clyborne remained liable to them for minimum royalties, etc., under the original leases. With respect to the leases acquired in the joint names of Clyborne and Franks (and in one instance W. M. Culbertson, Jr., hereafter called Culbertson), Clyborne first acquired by assignment the outstanding interest in the leases in his own name, agreeing to assume the obligations of the assignors under the leases and pay them an overriding royalty on coal produced thereunder, usually being 21/2 cents per ton, and then assigned the entire interest in the leases to Paragon. Paragon paid Clyborne the 30-cent royalty for which it was obligated, and Clyborne then paid the basic and overriding royalties to the landowners and others, retaining the balance himself. The basic royalties ranged from 10 cents to 20 cents per ton. The overriding royalties to Franks or Culbertson were usually 21/2 cents per ton. Clvborne retained 10-cents to 15 cents of the royalty paid by Paragon.

The details of these transactions which are pertinent here are set out below. Generally speaking, respondent has recognized as an overriding royalty paid to Clyborne an amount equal to the overriding royalty paid to Franks or others. All of the Paragon royalty not paid out or so recognized as basic or overriding royalty was determined to be a dividend from Paragon to Clyborne.

The various properties in which Clyborne acquired an interest and later transferred to Paragon, which are pertinent here, are: [fol. 1283] Cole Heirs' Tract. The first properties in which Clyborne acquired interests were owned by the Cole heirs. By a series of 10 instruments dated August 1, 1945, to September 13, 1947, which were generally executed after Franks had negotiated and obtained the landowners' verbal commitment or option, the Cole heirs conveyed title to all the coal and other minerals underlying some 531.1 acres of surface and title in fee simple to some 228.5 acres of land to Franks and Clyborne for a total consideration of \$24,862.50.

On August 24, 1948, Clyborne, joined by his wife, executed a deed by which he conveyed his undivided one-half interests in the Cole heirs' tract to Clyborne, Incorporated, for a consideration of \$65,000. Clyborne specifically reserved the Cary seam from the interests thus conveyed. The Cary seam lies above the Jewell seam and produces a steam coal.

By "deed of lease" dated October 22, 1951, Franks, joined by his wife, and Clyborne, Incorporated, leased to Clyborne the exclusive right to mine, "by the deep mining method," the coal from the Jewell seam in the Cole heirs' tract, for a royalty of 20 cents per ton, with a minimum [fol. 1284] royalty of \$2,000 per year beginning on January 2, 1955. One-half of the royalties were to be paid to Franks; one-half to Clyborne, Incorporated. The lease was for a 3-year period from January 2, 1954, with automatic renewal for 3-year periods until all of the mineable and merchantable coal in the Jewell seam (based on an 85 percent recovery), was mined and removed.

By this and other such references, we make no findings with respect to the status of any interest in any parcel or parcels of land for purposes of section 614 of the 1954 Code.

The parties disagree on brief as to the exact acreage involved in the conveyances, copies of which have been stipulated, and there appears to be a difference of \$50 as to the consideration paid for the minerals. Our summary is the most accurate which we can glean from the entire record. The differences appear to be due to questions as to whether a 6.1-acre tract had been included in a prior conveyance, and whether small areas excepted in some deeds for interests in minerals related to grants of easements or go grants of coal.

By "deed of assignment" dated October 22, 1951, Clyborne, joined by his wife, assigned his interests under the foregoing lease to Paragon in consideration of Paragon's assumption of Clyborne's obligations under the lease and the payment of a royalty of 30 cents per ton of coal mined under the lease, which royalty was to be distributed as follows:

		- 7	
Franks Clyborne, Inc Clyborne	orporate	d	10 10 10

Dennis Tract.—On May 1, 1946, W. Clyde Dennis, joined by his wife, leased to Clyborne and Franks all the coal underlying a 114-acre tract for 10 years, with the privilege on the part of the lessees to renew the lease for additional 10-year periods. The royalty was to be 10 cents per ton for all coal mined by the "tunnel or drift mouth mining method" and 20 cents per ton strip mined. Minimum royalty was to be \$100 per year. Assignment of the lessees' interests was to be only with Dennis' consent, and the lessees were to remain personally liable under the lease in the [fol. 1285] event of subletting or assigning. The lessees were to purchase from Dennis, who was in the insurance business, all the insurance coverage involved in the mining operations.

By deed of assignment dated June 3, 1953, Franks, joined by his wife, assigned his interest in the Dennis lease to Clyborne in consideration of Clyborne's assumption of his obligation and of Clyborne's payment to him of a royalty of 5 cents per ton of coal mined under the lease. On the same date, Clyborne assigned his interests in the lease to Paragon, which assumed Clyborne's obligations. Paragon was to pay a royalty of 30 cents per ton to be distributed as follows:

The tract described in the lease consisted of about 116 acres, of which Dennis apparently owned 114 acres in fee and 2 acres of surface only. This was originally a part of the Cole property.

	4		Cents
Dennis			10
Franks		1.	5 .
Clyborne		4	15

Because of dissatisfaction with the provision for the purchase of insurance from Dennis, in a supplemental lease dated May 1, 1956, the provision was omitted and the royalty payable to Dennis was increased to 15 cents. Franks assigned his interest in this supplemental lease to Clyborne in consideration of a royalty of 2½ cents per ton, and on June 15, 1956, Clyborne assigned his interest to Paragon by a deed of assignment which provided for a 30-cent-perton royalty to be paid by Paragon and distributed as follows:

.11			• .	Cents
Dennis	,	com.	 	15
Franks	-:		1.	21/2
Clyborne			 	121/2

[fol. 1286] McNeil Fract.—By deed of lease dated August 1, 1946, a group of related landowners known as the McNeil heirs leased to Clyborne, Franks, and Culbertson all the coal underlying a 750-acre (approximately) tract. Royalty was 15 cents per ton, with a minimum royalty of \$1,000 per year for the first 2 years and \$4,000 per year thereafter. The lease provided for a wheelage charge of 2½ cents per ton to be paid to the lessors. It was superseded by a lease dated August 1, 1948, providing for royalty of 15 cents, minimum annual royalty of \$4,000, and wheelage of 2½ cents per ton.

On January 12, 1951, Culbertson and Franks assigned their interests in the McNeil lease to Clyborne in consideration of the payment to each of them of a royalty of 2½ cents per ton, plus \$2,500.

This amount represented minimum royalties theretofore paid by Franks and Culbertson and was to be reduced by any amounts which it was determined they owed Clyborne. The amount of \$2,500 was to be paid to each of Franks and Culbertson.

Clyborne, on October 22, 1951, assigned his interests under the McNeil lease to Paragon, which agreed to assume his obligations under the lease and to pay a royalty of 30 cents per ton, to be distributed as follows:

	1.75	Y'.	- C	ents
Landown	ners	. 4	1/4	5
Franks			1.3	21/2
Culberts	on .	8 . /	11/	21/2
Clyborne		. : /	1	0

Clyborne was subsequently engaged in litigation with the lessors with respect to the provision for wheelage. He [fol. 1287] was the losing party in the litigation and was required to pay approximately \$85,000 to the lessors, plus amounts in the future. See Chyborne v. McNeil, 201 Va. 765, 113 S.E. 2d 672 (1960).

Mary Day Tract.—On March 1, 1951, Mary A. Day, joined by her husband, executed a deed conveying to Franks and Clyborne title to all the coal underlying a 67.5-acre tract, for a stated consideration of \$1,345 plus land valued at \$1,000.

On January 2, 1952, Franks leased his one-half undivided interests in the coal in the Jewell seam in this property to Clyborne for a royalty of 10 cents per ton, with a minimum annual royalty of \$325 until 85 percent of the merchantable and minable coal from the Jewell seam was mined. On the same date, Clyborne assigned this lease of an undivided one-half of the Jewell seam on the Mary Day tract to Paragon for a royalty of 20 cents per ton, of which 10 cents was to be paid to Franks and 10 cents to Clyborne.

Also on January 2, 1952, Clyborne leased his own undivided one-half interest in the Jewell seam to Paragon for a royalty of 10 cents per ton, with minimum royalty of \$325 per year until 85 percent of the merchantable and minable coal was removed.

[.] This was also originally a part of the Cole property.

Brown Heirs' Tract No. 1.—By lease dated April 28, 1952, a group of related landowners, known as the Brown heirs, leased to Clyborne the coal in the Jewell and Cary seams underlying some 889 acres. The royalty was 15 cents per ton of coal deep mined from the Jewell or Cary seams and [fok 1288] 25 cents per ton of coal strip mined from the Cary seam, with a minimum annual royalty of \$4,000 payable until 85 percent of the merchantable and minable coal was removed.

On October 28, 1952, Clyborne assigned to Paragon his interests under the Brown heirs lease (covering tract No. 1) for a royalty of 30 cents per ton, of which 15 cents was to be paid the lessors and 15 cents was to be retained by

Clyborne.

Tazewell Coal & Iron Company Tract.—On July 1, 1950, Tazewell Coal & Iron Company leased to John J. Jewell all the coal in the Jewell seam underlying an estimated 200-acre tract, for a 5-year term. The royalty payable to the lessor was 20 cents per ton, except that for any month when the average gross selling price of coal at the mine was \$5.50 per ton, or over, the royalty was to be 25 cents per ton. Minimum annual royalty was \$1,000. The lease was for a term of 5 years, but on August 1, 1952, the term was extended to 10 years from July 1, 1950.10

By deed of assignment dated November 12, 1953, Jewell assigned his interests under the Tazewell Coal & Iron Company lease to Clyborne for a consideration of \$2,250. This amount was to be adjusted for the amount of merchantable and minable coal underlying the tract: If such coal in the Jewell seam exceeded 450 acres, Clyborne was to pay the assignor at the rate of \$5 per acre for such excess; if such [fol. 1289] coal was less than 450 acres, the assignor was to refund to Clyborne at the rate of \$5 per acre for such deficiency. In this assignment it was specifically provided

No specific provision was made for payment of 25-cent-per-ton royalty to the Brown heirs in the event Paragon strip mined the Cary seam.

¹⁰ The provisions of a second amendment of November 11, 1953, are not shown by the evidence.

that Clyborne, in turn, could assign his interests to Paragon, in which event, upon Paragon's assumptions of his obliga-

fions. Clyborne was to be discharged.

On December 7, 1953, Clyborne and the Tazewell Coal & Iron Company entered into an agreement by which the latter consented to the assignment of Jewell's interests to Clyborne and agreed that Clyborne could assign his interests to Paragon if Paragon assumed the obligations of the lessee, in which event Clyborne was to be fully discharged under the lease.

Also on December 7, 1953, Clyborne assigned his interests to Paragon for a royalty of 30 cents per ton, of which, 20 cents was to be paid Tazewell Coal & Iron Company, and 10 cents was to be retained by Clyborne.

Metcalf Tract.—On July 9, 1953, Carl F. Metcalf (hereafter called Metcalf) leased to Franks for 10 years all the coal above and in the Allen Spring seam underlying a 136-acre tract. Metcalf was Franks' son-in-law. Royalty was

15 cents per ton.12

By instrument dated August 2, 1953, Franks assigned to Clyborne his interests in the Metcalf seam in return for a royalty of 2½ cents per ton payable to Franks. Also on August 2, 1953, Clyborne assigned his interests to Paragon, which was to pay a royalty of 30 cents per ton, of which [fol. 1290] 15 cents was to be paid to Metcalf, 2½ cents to Franks, and 12½ cents was to be retained by Clyborne.

Hinton Heirs' Tract.¹³—On September 1, 1953, Etta Hankins and other Hinton heirs leased to Clyborne all the merchantable and minable coal in the Jewell seam underlying some 1,173 acres. The lease provided for a royalty of 15 cents per ton with a minimum annual royalty of \$4,000

¹¹ No specific provision was included for payment of the 25-cent royalty to Tazewell Coal & Iron Company if the gross selling price of the coal mined reached \$5.50.

¹² This was also originally a part of the Cole property.

¹³ This tract was also referred to as the Hankins tract in the record.

until 85 percent of the coal was removed. The lessee had the right to transport at no cost, over and through the leased property, coal mined from the property, but was to pay wheelage of 2 cents per ton for transportation of other coal. The Hinton heirs had previously leased to Clyborne and Franks the Cary seam on the property, and they had leased the Jawbone seam to Franks and Culbertson. In the event of assignment, Clyborne was to be personally liable under the lease.

By deed of assignment dated January 30, 1956, Clyborne assigned has interests in this lease to Paragon. This assignment provided for a royalty of 30 cents per ton, of which 15 cents was to be paid to the lessors, and 15 cents was to be retained by Clyborne as consideration for the assignment.

Brown Heirs' Tract No. 2.-By deed of lease dated December 1, 1954, the Brown heirs leased to Clyborne all the merchantable and minable coal in the Jewell (called "Jewell Ridge" seam in the lease) seam and in the Cary seam underlying a 573.8 acre tract for a royalty of 15 cents per ton for coal deep mined from either seam or auger mined [fol. 1291] from the Cary seam, and a royalty of 25 cents. per ton of coal strip mined from the Cary Seam. Minimum annual royalty was \$2,500 until 85 percent of the merchantable and minable coal was mined. Clyborne was given the right to transport any coal mined from the tract over and through the property without charge. Also, Clyborne could transport, free of charge, over and through the Brown heirs' tract No. 1, any coal mined from the property. But Clyborne had to pay a wheelage charge of 2 cents per ton for any other coal transported over or through the property. Clyborne could assign his interests under the lease, but he was not to be thereby relieved from his obligations under it.

On December 2, 1954, Clyborne assigned his interests under this lease to Paragon, to the extent that the latter was given the right to deep mine the Jewell (or, as it was termed in the assignment, the Jewell Ridge) seam in consideration of a royalty of 30 cents, of which 15 cents was

to be paid to the lessors and 15 cents was to be retained by Clyborne.

Clyborne also purchased either the minerals or the fee in

two other tracts from the Brown heirs.

A summary of the royalties paid by Paragon with respect to the leases here involved to Clyborne and others and the amount paid to Clyborne and disallowed as royalties by respondent is as follows:

[fol. 1292]	0 9	1 7		
	Total royalty	Paid to	Paid to	Disallowed
Tract	per ton paid by Paragon	others	Clyborne	respondent
McNeil	\$0.30	\$0.20	\$0.10	\$0.05
Cole heirs	.30	.20	.10	.10
Mary Day	9	1	/	
$(\text{Franks}-\frac{1}{2})$.20	.10	.10	.10
Mary Day.	1 1	, , , ,		
(Clyborne 1/2) .10	/	.10	
Brown heirs				./ : 1
No. 1	.30	.15	.15 •	.15
Dennis		- /		· ·
(First lease)	30	.15	.15	.10
Dennis	le to	1		
(Second lease)	.30	.175	.125	.10
Metcalf	30	.175	.125	.125
Tazewell Coal &	1 /	o .	19	
Iron Co.	.30	.20	.10	.10
Brown heirs	- 10	K		
No. 2	.30	.15	.15	15
Hinton heirs	30	.15	.15	° .15

Jewell Smokeless Coal Corporation, which has been operating in the Buchanan County area since 1951, and some of whose properties adjoin those of Paragon, made leases of the Jewell seam as follows:

1952-tonnage royalties-20 cents.

1955 tonnage royalties from 15 to 20 cents.

1956-tonnage royalties-25 cents.

1959-tonnage royalties-25 cents.

Jewell Smokeless has also taken leases in this area under which it has paid an overriding royalty of 10 cents or more per ton.

Jewell Ridge Coal Corporation, which has been mining in the same general area since about 1910, entered into leases of the Jewell seam in Buchanan County, Virginia, and McDowell County, West Virginia, during the period 1950 to 1955, calling for tonnage royalties of 15 cents and 16 cents, with higher royalty provisions for the better grades of coal and if Jewell Ridge mined the coal from the surface.

A royalty of 25 cents per ton was reasonable for Paragon to pay during the years here involved. Royalties paid by Paragon to Clyborne in excess of 25 cents per ton were distributions of Paragon's earnings and profits to Clyborne.

[fol. 1293] Opinion.

Paragon claimed deductions for amounts paid Clyborne, its principal stockholder, as coal royalties. Clyborne reported the amounts he received from Paragon in excess of royalties he paid others as overriding royalties taxable as capital gains under section 631 of the 1954 Code. Respondent disallowed all or a part of the overriding royalties retained by Clyborne as deductions to Paragon and denied Clyborne the benefit of capital gains treatment thereon. Essentially, it is respondent's position that the amounts in controversy paid Clyborne by Paragon constitute dividends to Clyborne, taxable as ordinary income, and are nondeductible by Paragon.

Respondent does not attack the existence of Paragon as a separate taxable entity, but he does claim (1) that Clyborne had no assignable interest in the leaseholds for which Paragon could be required to pay an overriding royalty, (2) that the payments of overriding royalties by Paragon to Clyborne were both unrealistic and unreasonable in amount, designed solely for the purpose of obtaining a tax advantage by providing a deduction for Paragon

¹⁴ All section references are to the Internal Revenue Code of 1954 unless otherwise indicated.

of an amount which would be taxable as capital gains to its principal stockholder, and (3) that the amounts paid were not in fact royalties but were dividends.

A stockholder may deal with his controlled corporation and transactions entered into between them may be accorded recognition for tax purposes. Sun Properties v. [fol. 1294] United States, 220 F. 2d 171 (C.A. 5, 1955): Differential Steel Car Co., 16 T.C. 413 (1951). Furthermore, taxpavers may arrange their affairs in such a manner as to minimize income tax. Gregory v. Helvering, 293 U.S. 465 (1935). However, transactions between a stockholder and his controlled corporation warrant close scrutiny to determine that they are not mere artificialities. correct in form but lacking substance; contrived as a disguise for distribution of corporate earnings. Ingle Coal Corporation v. Commissioner, 174 F. 2d 569 (C.A. 7, 1949), affirming 10 T.C. 1199 (1948). The courts are not required to accept transactions between a stockholder and his controlled corporation, wherein the stockholder makes the decision for both sides, at face value for tax purposes. Limericks. Inc. v. Commissioner, 165-F. 2d 483 (C.A. 5. 1948), affirming 7 T.C. 1129 (1946). It is not enough that Paragon by virtue of the assignments between itself and Clybornel was formally obligated to pay royalties to Clyborne. Ingle Coal Corporation v. United States, 127 F: Supp. 573 (Ct. Cl. 1955). The payments are deductible as royalties by Paragon under section 162(a)(3) only to the extent that such payments are "required to be made as a condition to the continued use or possession . property * * ." In determining whether payments made by a corporation to its controlling stockholder are "required" we think it is inescapable that the Court/must inquire into the reasonableness of the amount paid, Limericks. Inc. v. Commissioner, supra; in other words, it becomes necessary to determine what the corporation would have been required to pay for the use of the property to an unrelated party dealing at arm's length under the same circumstances. [fol. 1295] The question of the reality of the transactions

between Paragon and Clyborne, as well as the reasonable-

ness in amount of the royalties provided for therein, is a question of fact. A voluminous amount of evidence was offered by both parties on this issue and it would be impractical and would serve no useful purpose to elaborate on the details of this evidence. Suffice it to say that we have given careful consideration to all of the evidence

in reaching our conclusions.

We find no basis for respondent's contention that Clyborne had no assignable interest in the leases for which Paragon could be required to pay an overriding royalty. which contention seems to be based on the premise that Clyborne was acting for Paragon in acquiring the leases. The evidence indicates that Clyborne entered into the activity of blocking up leases of coal properties in the Whitewood area in his individual capacity several years before the properties were opened up for mining and before the corporation was even organized. The Cole heirs' tract was acquired by Franks and Clyborne between 1945 and 1947, as was the Dennis tract. While the Mary Day tract was originally purchased in 1951 and the lease of the Metcalf tract was acquired in 1953, they were both parts of the original Cole property and served to round out property previously acquired. The original lease on the McNeil tract was acquired by Franks, Culbertson, and Clvborne between 1946 and 1948. Paragon was not incorporated and did not begin operation until 1951. We see no reason why Clyborne, having actively engaged in blocking up leases in his individual capacity before the corporation was formed; should not have continued this activity of acquiring subsequent leases in his own name even though [fol. 1296] he knew the properties would be operated by Paragon.

There is considerable evidence that some of the landowners in this area were not willing to grant a lease directly to a corporation but insisted on leasing to individuals on whose personal financial responsibility they could rely. The oral evidence on this point is supported by a provision contained in the Brown heirs No. 2 lease which specifically provided that Clyborne might assign the lease to Paragon but that he would be required to remain personally liable under the terms thereof. In some instances, Clyborne assigned to Paragon only the rights to mine the Jewell seam or other specific seams of coal while retaining for himself the right to mine other seams. There would also seem to be an adequate business reason for Clyborne to take the leases in his own name first and then assign them to Paragon. In the event Paragon failed, the leases would revert to Clyborne as long as he paid the minimum royalty rather than revert directly to the landowners.

For the above and other reasons we find that Clyborne was acting in his individual capacity in acquiring the leases in his own name and, consequently, that he had an assignable interest in the coal for which Paragon could be required to pay a royalty. Respondent's reliance on Utter-McKinley Mortuaries v. Commissioner, 225 F. 2d 870 (C.A. 9, 1955), affirming a Memorandum Opinion of this Court,

is misplaced. It is distinguishable on the facts.

There can be little doubt from the evidence that Clyborne and Paragon intended the payments to Clyborne to be royalties. The written assignments specifically provide therefor, the books and records of both parties treated the [fol. 1297] payments as royalties, and there is no evidence from which to conclude that the parties intended them to

be anything other than royalties.

The principal question seems to be whether the amounts paid by Paragon as royalties and the amounts received and retained by Clyborne as overriding royalties were fair and reasonable, when judged by standards of transactions entered into by parties dealing at arm's length. The parties agree that only the amount found to be deductible as royalties by Paragon should be treated as royalties received by Clyborne,

In the light of the evidence presented we could not definitely conclude that an unrelated corporation, under certain conditions, would not have agreed to pay Clyborne a royalty of 30 cents per ton for the coal mined from these properties. There was a good bit of oral testimony that a fair and reasonable royalty for Jewell seam coal with the chemical qualities of this coal would be between 30 cents and 40 cents per ton. However, there was no written

evidence to support these assertions and they may have been colored somewhat by passage of time. The period we are interested in is the period between 1951 and 1958. and the evidence indicates that the price of good metallurgical coal has been rising during and since that time. The written evidence presented tends to refute these oral assertions. As a matter of fact, judging from the evidence presented, both oral and written, it would appear that there was no precise figure that could be said to be a fair and reasonable royalty, or the going rate of royalty, on this coal in this area. It apparently was a question of bargaining on each lease, and the numerous variables in [fol. 1298] circumstances and personalities appear to have made the price equally as variable, within limits. However, using our best judgment based on all the evidence, we have concluded that an unrelated corporation in Paragon's position, whose officers had available all the information Clyborne had as an officer of Paragon, would not have been required to pay more than 25 cents per ten as royalty for the coal mined under the leases here involved.

The written evidence introduced in the form of leases held by Jewell Smokeless Coal Corporation and Jewell Ridge Coal Corporation, both being corporations operating in the Jewell seam in Buchanan County, indicates that those corporations were able to acquire the right to mine the Jewell seam in that area by paying royalties ranging from 15 cents per ton to 25 cents per ton. Clyborne himself was able to acquire some of the leases here involved for royalties ranging between 15 cents and 20 cents per ton.

We recognize that the practice of obtaining leases and assigning them to operating companies for an overriding royalty was prevalent in this area and that all of the operating companies knowingly paid overriding royalties on some of their leases. Consequently, we do not think it unreasonable that Clyborne should charge Paragon an overriding royalty for leases he assigned to it. With respect to the earlier leases, Clyborne and Franks went to considerable trouble and some expense in blocking up those leases. The evidence does not indicate how much time and effort Clyborne might have spent in obtaining the later

leases which he took directly from the landowners in his own name. We do know that in the latter instances he assigned the leases within a relatively short time after [fol. 1299] he acquired them at an overriding royalty rate of 15 cents per ton. However, the date of execution of the leases does not indicate how much time might have been spent in working out the agreement. Also, Clyborne assumed liability for and remained personally liable for the minimum royalties under these leases, which totaled a considerable amount each year. We think these and other factors justify Clyborne in charging even his own corporation a reasonable overriding royalty.

We do not think the relationship between Clyborne and Paragon should cause us to deny that Clyborne may have been able to make bargain purchases of the leases which he should be entitled to pass on to his controlled corporation at a profit to himself as long as the corporation was not required to pay more than a reasonable royalty under the circumstances. Clyborne's good fortune should not control the question of whether the royalty paid by Paragon was reasonable and required. Judging from the foyalties paid by other companies operating in the area, Clyborne apparently was able to make some bargain purchases in acquiring these leases at a 15-cent royalty rate. Furthermore. Paragon was able to earn a reasonable profit even after paying a 30-cent royalty. However, we do believe that the overriding royalty charged by Clyborne was excessive for what he had to give to Paragon and also forced the total royalty paid by Paragon above the amount that would have been paid by an unrelated corporation dealing with Clyborne at arm's length under the same circumstances.

The preponderance of the evidence seems to indicate that a reasonable overriding royalty would not exceed 10 cents per ton and that the royalty Paragon could have expected to pay, dealing at arm's length under the circumstances [fol. 1300] here present, would have been 25 cents per ton. Consequently, we conclude that 25 cents per ton of the amounts paid to Clyborne by Paragon represented royalties deductible by Paragon as ordinary and necessary



business expenses under section 162(a)(3), and that the remaining 5 cents per ton paid by Paragon to Clyborne represented a nondeductible distribution of corporate earn-

ings and profits and a dividend to Clyborne.

We realize that the overriding royalty allowed Clyborne as a result of the above conclusion would not be the same in all cases. However, the basic question is what amount Paragon would have been required to pay as royalty dealing with a stranger at arm's length and we have considered the reasonableness of the overriding royalty received by Clyborne only as one of the factors in deciding the basic question. Consequently, we have determined that the amount of royalty deductible by Paragon under all of the leases was 25 cents per ton, and that the amount taxable to Clyborne as royalties received is the difference between 25 cents per ton and the amounts required to be paid to the landowners and others as royalties and overriding royalties. The remaining 5 cents per ton paid by Paragon under all the leases is not deductible by Paragon and is taxable to Clyborne as a dividend.

[fol. 1301]

2. Depletion Issue.

Findings of Fact.

Paragon acquired by assignment written leases on the coal in and underlying the land here involved in Buchanan County, Virginia, which leases required the lessee to mine either all or 85 percent of the minable coal in and underlying the tracts under lease. Paragon assumed all the obligations of the lessees under the leases, and was obligated to pay annual minimum royalties, tonnage royalties, and land taxes. After acquiring the leases, Paragon made substantial investments necessary for mining, processing, and marketing the coal underlying the leased boundaries, including construction and maintenance of a tipple, processing equipment, a powerline, a railroad sidetrack with four spurs running under the tipple, and a road from the tipple around the mountain close to the outcrop line of the coal over which coal could be trucked from the mines to the tipple. Paragon chose not to mine the coal itself but contracted the mining out to various individuals and firms who were to mine the coal at their own expense and deliver the coal to Paragon's tipple. Paragon would then clean and size the coal and sell it on the market.

Petitioners Lee, Wesley, and Watson formed a partner-ship called Standard Smokeless Coal Company in 1953, and entered into an oral agreement with Paragon to mine the coal from a certain area of the Paragon lease. Standard mined coal from the Paragon property under this agreement during each of the calendar years 1954, 1955, and 1956. The above petitioners were partners in Standard in each of those years and petitioner Jack became a partner during the year 1956.

Petitioners Wesley, Bowling, and Watson formed another [fol. 1302] partnership in 1954 or 1955 known as Kyva Mining Company and entered into an oral agreement with Paragon to mine coal from another location or area included in the Paragon lease. In 1956 Kyva bought the equipment and mining rights of Sampy Lester, who was operating a mine adjacent to the Kyva mine under oral agreement with Paragon, for \$3,500, all of which is allocated to depreciable assets on its books and claimed depreciation thereon. Kyva produced coal under these agreements during each of the calendar years 1955 and 1956, and the above-named petitioners continued to be partners therein except that Bowling was not a partner after 1955 and petitioner Jack became a partner in the year 1956.

Petitioners Lee, Wesley, and Bowling formed another partnership in 1956 known as Farwest Coal Company and bought out the equipment and interests of Meadows Coal Company, which had been producing coal from still other areas or locations included in the Paragon leases under an oral agreement between Meadows and Paragon made in 1954. Farwest agreed to pay Meadows approximately \$21,000 for its equipment and mining rights and allocated the entire amount to equipment on its books which it depreciated for tax purposes. Farwest obtained the consent of Paragon before buying out Meadows. Farwest produced coal from the mine originally opened by Meadows during the year 1956. The above-named petitioners were the part-

ners therein during the year 1956 and petitioner Jack be-

came a partner in 1957.

Coal-was also mined under the Paragon leases at different locations by C. W. Stilwell and S. W. Stilwell, operating as partners under the trade name of Bare Ridge Coal Company, during Paragon's taxable years ending Septem-[fol. 1303] ber 30, 1955, 1956, and 1957, under an oral agreement made in 1951 between Paragon and the Stilwells; by Sherman Meadows, operating as Meadows Coal Company, during Paragon's taxable years ending September 30, 1955 and 1956, under an oral agreement entered into between Paragon and Meadows in 1954, the rights in which were assigned by Meadows to Farwest in 1956 as mentioned above; and by Sally Mining Company, a partnership comprised of George Beall and Lloyd Conley, during Paragon's taxable years ending September 30, 1955, 1956, and 1957, under an oral agreement entered into between Paragon and the partners in 1955. The Stilwells, Meadows, and Beall and Conley are not petitioners herein but Paragon claimed depletion on the coal mined by them during its taxable years here involved as it did on the coal mined by Standard, Kyva, and Farwest as above mentioned.

Most of the oral agreements here involved were made between the contractors and Paragon's then superintendent, Grogan, who died before the trial of this case. Consequently, it is impossible to determine with any certainty the exact terms of the oral agreements. However, based on the evidence presented and the conduct of the parties, the oral contracts between Paragon and the original contractors appear to have been arrived at in the following man-

ner and to include the following provisions.

As Paragon extended a road around the side of the mountain a prospective contractor would be taken to various proposed sites for mine openings. When the contractor had chosen a particular site the representative of Paragon would point out on an overall property map, or with his arms on the surface of the ground, the general area in which the contractor could mine. The contractor agreed to [fol. 1304] mine the coal in that area and to deliver it to Paragon at its tipple at his own expense. Paragon usually would face up the site for the mine portal but the con-

tractor was required to provide his own men, equipment, chutes, and bins, and to extend a road from the road built by Paragon to the mine portal if necessary. All expenses of opening and operating the mine were borne by the contractor. The contractor did not assume any of Paragon's obligations under its leases and paid no royalties or taxes

on the property or the mineral interest.

Paragon agreed to pay the contractor a fixed price per ten for coal delivered to its tipple, less 2½ percent for rejects. It was understood that the price might vary from time to time. The price paid by Paragon to the various contractors did vary up and down from time to time, depending somewhat on the general trend of market prices for the coal over extended periods and to some extent on labor costs. However, price changes made by Paragon to the contractors were always prospective and the contractors were notified several days in advance of any price change so that they always knew the price they would get for coal when they delivered it to the tipple. The contractor had no further control over the coal after it was delivered to Paragon's tipple and did not know how or for what price Paragon sold or otherwise disposed of the coal.

The contractor agreed either to provide his own power with his own compressors or to buy power from Paragon at a fixed rate per ton; in the latter event the contractor was required to convert the current from a.c. to dc. at his own expense. The contractor also agreed to pay a certain amount per ton for engineering services inside the mine [fol. 1305] rendered by an engineer provided by Paragon. Paragon was to pay for all engineering services outside

the mine.

After the agreement was made the engineer employed by Paragon provided the contractor with a mine map for his mine with projections thereon at approximately 60-foot intervals showing the general direction in which the mine should progress. Inasmuch as the various mines opened up around the side of the mountain all headed generally toward the center of the mountain, the engineer would indicate on the mine maps where barriers between adjacent mines should be left so that one contractor did not break through into the mine of the adjacent contractor. The

engineer also set spads for the contractor to indicate the general direction in which he was to mine. The engineer extended the projections from time to time and also provided the contractors with mine maps showing the areas mined, the remaining pillars, etc., at about 6-month intervals. Paragon insisted on all contractors using the same engineer, who could project a system for mining all the coal under its leases without leaving unrecovered pockets of coal and to prevent one contractor from breaking into the mine of another contractor. The contractors were required to obtain Paragon's permission before pulling pillars as they retreated from an area which had been mined. The contractors usually tried to develop their mines to produce a specified tonnage of coal per day, without which they did not think they could operate at a profit. It often took some time to develop a mine to this production stage.

At the time the oral contracts were entered into nothing was said about who was entitled to depletion, although [fol. 1306] Paragon expected to claim depletion and fixed the price it would pay the contractors with that in mind.

The contracts were not made for any specific period of time and nothing was said about the right to terminate by geither party at the time the agreements were entered into. Numerous contractors ceased mining from time to time as they found they were unable to mine coal profitably or for other reasons of their own. Contractors who ceased mining were not permitted to remove buildings from the premises but usually took their equipment with them unless they had borrowed money from Paragon with the equipment as security. It was anticipated by both parties that a contractor. would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications. The contractors were not obligated to mine any specific amount of coal and were not specifically given the right to mine any particular area to exhaustion. The projections of the mines were based somewhat on the speed with which the contractor produced the coal in his area. If, with proper mining methods, he reached a point where he might intersect another mine as projected, the first contractor to reach the point of intersection might be given the right to pierce the indicated barrier between he two mines and mine on forward. Also, if an adjacent mine ceased operating, the contractor was often permitted to pierce the indicated barrier between the two mines and recover the coal which would normally have been reached through the discontinued mine.

During the years here involved, Paragon took all mer[fol. 1307] chantable coal produced by the various contractors operating on Paragon's leased property and paid the
contractors the price fixed by Paragon. Paragon sold very
little of its coal under contract and the prices it obtained
for coal varied quite frequently. If Paragon was unable to
take all of the contractors' coal either because of lack of
coal cars or because its tipple was full, the contractor would
fill his own bins and then shut down until Paragon could
take more of his coal.

The contractors completed their obligations under the contracts by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay them so much per ton. The contractors were not concerned with the sales price Paragon received for the coal.

The contractors paid nothing for the privilege of mining coal other than their investment in equipment, roads, and buildings, and their cost in opening the mine and mining the coal. They acquired no legal title either to the coal in place or to the coal after it was mined. The coal as delivered to Paragon's tipple by the contractors was not in a state which was salable to the consumer but had to be washed, graded, and treated in order to be salable upon the consumer market. All such processing was done by Paragon at its processing plant. The contractors sold none of the coal to anyone other than Paragon and were not entitled to do so.

During its taxable years ending September 30, 1955, 1956, and 1957, Paragon paid the following amounts to the following partnerships for coal produced under the above oral agreements:

[fol. 1308]

	1955	September 30, 1956	1957
Standard	\$151,368.53	\$146,877.01	\$134,535.80
Kyva	57,542.58	160,247.83	190,509.24
Farwest	-	8 -	. 165,560.70
Bare Ridge	298,297.63	258,435.03	269,532.59
Sally	10,162.17	66,907.54	71,117.70
Meadows	301,635.27	183,738.74	18,496.06
Total	819,006.18	816,206.15	849,752.09

Paragon claimed percentage depletion on the above amounts on its income tax returns for the above years.

Standard and Kyva received the following gross receipts from their operations under the Paragon leases, and claimed percentage depletion on those amounts on the partnership returns for the calendar years following:

8	1954	1955	1956
Standard.	\$103,850.66	\$154,457.69	\$145,741.26
Kyva		78,623.18	191,374.5915

Respondent disallowed the above deductions for depletion claimed by both Paragon and the contract miners but agreed at the trial that either Paragon or the contract miners are entitled to the depletion deduction, but not both.

[fol. 1309] Opinion.

Section 611 provides that in the case of mines there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion to be made under regulations prescribed by the Secretary or his delegate. In the case of a lease the deduction under this section shall be apportioned between the lessor and lessee. Sec-

¹⁵ According to stipulation of the parties. However, a lesser amount was shown on the return for Kyva for the year 1956 and percentage depletion computed accordingly. Kyva did receive gross receipts in 1956 in the amount shown above.

tion 613 provides that the allowance for percentage depletion of coal shall be 10 percent of the gross income from the property, excluding an amount equal to rents or royalties paid, such allowance not to exceed 50 percent of the taxpayer's taxable income from the property. The gross income from the property is defined as gross income from mining.

There have been numerous cases involving the question of who is entitled to percentage depletion with respect to the production of minerals. In Palmer v. Bender, 287 U.S. 551 (1933), the Supreme Court held that the language of the statute is broad enough to provide a deduction for any taxpayer who "has acquired, by investment, any interest in the oil in place, and secures, by any form of legal . relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." The Court further said that the deduction is not "dependent upon the particular legal form of the taxpayer's interest in the property to be depleted * * * . It is enough if . . he has retained a right to share in the oil produced. If so, he has an economic interest in the oil, in place, which is depleted by production." This concept of an economic interest in the mineral in place has been adopted by the courts and the regulations as the factor determining whether a taxpayer is entitled to depletion, [fol. 1310] but the question of what gives a taxpayer an economic interest in the mineral in place has posed many problems. For instance, in Helvering v. Bankline Oil Co., 303 U.S. 362 (1938), the Supreme Court said that the "phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production. through a contractual relation to the owner, by one who has no capital investment in the mineral deposit."

Where a lessee enters into an agreement with the owner of the mineral interest, coal in this case, giving the lessee the right to mine and remove all the coal in a seam or seams underlying a specified tract of land and obligating the lessee to mine and remove (or pay for) all or a specified percentage of the minable and merchantable coal in the seam or seams and to pay to the owner a royalty

of so much per ton for each ton of coal mined or minable, usually with a minimum annual royalty, and under which agreement the lessee has the right to sell the coal for whatever price he can obtain and retain the proceeds, there would seem to be no question that the lessee has acquired an economic interest in the coal in place, which is depleted by production and which, under the statutory scheme, entitles the lessee to the percentage depletion deduction, based on his gross income from mining, less rents and royalties paid.

Paragon meets the above requirements and, not having assigned or sublet its leases, it is entitled to the depletion deduction based on its entire gross income from the property, less rents and royalties paid, unless it has, by its agreements with the mining contractors, surrendered all or a part of its capital interest in the coal in place, or the contractors have in some manner acquired an economic [fol. 1311] interest in the coal in place which would entitle them to the depletion deduction on that part of the gross income from the property equal to the amount they receive for mining the coal. It is clear that if the contractors are entitled to a depletion deduction on the amounts earned under their contracts, the amount allowable to Paragen for depletion of its economic interest in the coal would be correspondingly reduced. Parsons v. Smith, 359 U.S. 215 (1959). The contractors here have not acquired any interest in the coal by purchase or lease from the landowners or their lessees, and consequently their right to the depletion deduction rests entirely on the interests they acquired under their contracts with Paragon. It is this situation, where the owner or lessee of coal in place chooses not to mine it himself but enters into a contract with an independent contractor to mine the coal for him, that has given rise to most of the controversies in recent years over which party is entitled to the depletion deduction. Respondent correctly agrees that one of the two parties is entitled to depletion on the amount paid the contractor, but not both.

We believe much of the uncertainty in this area was removed by the Supreme Court's decision in Parsons v.

Smith, supra. In that case, after reviewing the history of the depletion deduction, the Court said, "In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset." In the two cases there involved the facts were quite similar to those here involved except that is one case, which involved an oral agreement, it was agreed that if either party wanted to quit, all that was necessary to terminate the arrangement [fol. 1312] was the giving of a 10-day notice, and in the second case, which involved a written contract, it was expressly provided that the owner of the coal lands could terminate the agreement at any time upon 30 days' written notice, without specifying any reason therefor. The contractors there argued that their contractual right to mine coal from the designated lands and the use of their equipment, organizations, and skills in doing so should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place. The Court, referring to the assertion as a legal fiction, refused to indulge in the fiction because it found the fiction was negated by the facts. The opinion set forth the facts which the Court found to be opposed to the asserted fiction. being (1) that the contractors' investment was in equipment, not in coal in place; (2) their investment was recoverable through depreciation of the equipment; (3) the contracts were terminable on short notice; (4) the landowners did not agree to, nor did they, actually surrender any capital interest in the coal in place; (5) the coal at all times belonged to the landowners and the contractors could not sell or keep any of it, but were required to de-1 liver all coal to the landowners; (6) the contractors were to be paid a fixed sum for each ton mined and delivered and were not to have any part of the proceeds of the sale of the coal; (7) the contractors had to look only to the landowners for all sums to come due them under their contracts.

As mentioned above, we find that the obligations and rights of the parties here involved are similar in most respects to those involved in the *Parsons* case except there

was no specific right to terminate mentioned in the agree-[fol. 1313] ment between the parties.16 While such right on the part of the landowner to terminate an agreement on short notice and without cause may go far toward limiting the contractor's right to the depletion deduction we do not think the absence of a specific right to terminate necessarily gives the contractor an economic interest in the coal in place. We do not think that a contractor's investment in depreciable equipment and other property required to mine and remove coal, and the necessary expense he incurs in opening and operating a mine, gives him a depletable economic interest in the coal in place. where the contract, under which he is authorized to mine the coal and upon which his right to the depletion deduction rests entirely, simply authorizes him to mine the coal in a general area for an indefinite period with no obligation on his part to pay anything for the coal, or to continue mining until the supply of coal is exhausted, and does not permit him to sell the coal on the open market after it is mined. In our opinion such a contractor, by his investment, may obtain an economic advantage derived . from production but does not acquire an economic interest in the coal in place.

Here the contractors paid nothing for the coal while Paragon was obligated under its leases to pay a minimum annual royalty and a tonnage royalty on all coal mined, was required to pay taxes on the land and the mineral in place, and was required to remove, or pay a royalty for, [fol. 1314] at least 85 percent of the minable and merchantable coal. While there is some implication in the testimony that the contractors might have been entitled to sell the coal they produced elsewhere had Paragon not taken it all, this is refuted by the positive testimony of the representatives of Paragon that all coal had to be delivered

¹⁶ The testimony on this point is conflicting but we have concluded from all the evidence that the right to terminate was not specifically mentioned when these oral agreements were entered into. There is evidence that Paragon's superintendent had no authority to negotiate agreements that were not terminable at the will of the parties.

to Paragon, supported by the fact that all coal was delivered to Paragon, and the absence of any explanation why Paragon, which was obligated to pay a royalty on the coal, would permit the contractors, who had paid nothing for the coal and who had no legal title to the coal, to sell it elsewhere. These facts and others indicate that Paragon did not intend to nor did it actually surrender any capital interest in the coal in place to the contractors. In fact, most of the contractor-petitioners in this case disclaim any capital investment in the coal in place—the unmined coal. As said by the Supreme Court in Parsons v. Smith, supra:

Surely these facts show that petitioners did not actually make any capital investment in, or acquire any economic interest in, the coal in place, and that they may not fictionally be regarded as having done so.

The facts in Parson v. Smith, supra, indicate that petitioners' investments there were similar to the investments of the contractors here.

Furthermore, the contractors had no interest in the coal legally or otherwise after they had delivered it to Paragon. They were paid a fixed price per ton for coal delivered and had no knowledge or interest in the price that Paragon received from the sale of the coal to the consumer. While there is some evidence that the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs, there is no evidence that the amount paid by Paragon was directly [fol. 1315] related either to the price it was getting for the coal or to the sales price of a particular contractor's coal, and the amount was apparently changeable at the will of Paragon. It is also undisputed that the contractor knew the fixed sum he would receive before he delivered the coal. In other words, the contractor had to rely on the personal covenant of Paragon for payment for his services rendered in producing the coal.

It is not clear from the evidence whether the contractors were given any specific boundary of coal to mine. The evi-

dence rather indicates that the contractors were given a general area in which to mine under the supervision of an engineer who was authorized to plan a system of mining for the extraction of all the minable coal in the seam and who was authorized to change the projection of any contractor's mine in order to accomplish this objective. The contractors testified that the area they were given the right to mine was indicated to them by Paragon's superintendent either pointing out a general area on the surface of the ground or placing his hand on a property map which showed only the outcrop line of the coal with no division of the coal underground. Later the engineer provided mine maps with barriers shown thereon, but we believe the barriers were shown primarily to prevent adjacent contractors from breaking through into each other's mines and to equalize the rights of the miners according to their capabilities under a planned system of mining, and were not intended to specify definite boundaries for the areas of coal the contractor was entitled to mine. As pointed out by Paragon's present superintendent, Paragon did not know at the time the agreements were made what equipment and skills a particular contractor would use or how [fol. 1316] long he would stay, and because of the numerous rolls or faults characteristic of this seam of coal, it could not be determined in advance from just what direction the coal in an area would have to be mined to recover all minable and merchantable coal. But inasmuch as Paragon was obligated under its leases to remove at least 85 percent of the coal, the areas given to a particular contractor had to be and remain flexible.

The evidence is conflicting as to whether the contractors were given the right to mine a specific area of coal to exhaustion. However, there is very little conflict in the evidence that the contractors were not obligated to mine any boundary of coal to exhaustion and, in fact, many of them quit at any time they chose. It seems unlikely that the parties would have contemplated granting the contractor the nonterminable right to mine specific areas to exhaustion without also obligating him to so mine it. Furthermore, Paragon could not give an absolute nonter-

minable right to mine to exhaustion in view of the landowner's reserved rights under the Paragon lease to terminate in the event of noncompliance with the terms of the lease. While we cannot find that the right to terminate was specifically mentioned when the agreements were made, neither can we conclude that the agreements were nonterminable.

On the facts in this case we conclude that the contractors could look only to the difference in their cost of mining the coal and the amount Paragon paid them for a return of their investment, that they made no investment in and acquired no economic interest in the coal in place, and that consequently they are not entitled to depletion on the coal they produced. As a result we conclude that Paragon did [fol. 1317] have an economic interest in the coal in place and is entitled to deduct depletion from the gross income it received therefrom without reduction for the amount it paid the contractors.

We recognize that the Court of Appeals for the Fourth Circuit held in Stilwell v. United States, 250 F. 2d 736 (1957), that one of the contractors producing coal on the property here involved, under an oral agreement presumably similar to the agreements made with the contractors herein, was entitled to depletion on the coal he produced under the agreement for the year 1952. Court of Appeals, in reversing the District Court, found that the contractor's expenditures for equipment, a tipple at the mine entry, powder house and powerplant, and tracks inside the mine, while not of themselves amounting to an investment in the coal in place, did indicate that the parties did not intend the contract to be terminable so long as the contractor's operations were satisfactory and the coal could be profitably marketed. However, we must decide this case on the evidence presented here, and we cannot conclude from that evidence that the contractors. had a nonterminable right to mine the coal in any specific area to exhaustion. Without such right we do not believe that under the doctrine of Parsons v. Smith, supra, decided after Stilwell, the investment of these contractors in depreciable equipment and other property required to mine,

remove, and deliver the coal gave them an economic interest in the coal in place which would entitle them to the depletion deduction. See United States v. Stallard, 273 F. 2d 847 (C.A. 4, 1959); Utah Alloy Ores, Inc., 33 T.C. 917 (1960); Walter Bernard McCall, 37 T.C. 674 (1962), on appeal (C.A. 4); J. Shelton Bolling, 37 T.C. 754 (1962); [fol. 1318] William M. Legg, 39 T.C. — (Oct. 8, 1962), all decided subsequent to Parsons v. Smith, supra. Cf. Denise Coal Company v. Commissioner, 271 F. 2d 930 (C.A. 3, 1959), reversing an opinion of this Court on the issue here material, 29 T.C. 528 (1957), entered prior to the decision of the Supreme Court in Parsons v. Smith, supra.

Decision will be entered for the respondent in Docket No. 84124.

Decisions will be entered under Rule 50 in Docket Nos. 84122, 84123, 84125, 84126, 90765, and 90766.

[fol. 1319]

Before the Tax Court of the United States \
Docket No. 84122

ROBERT LEE MERRITT and WINNIE MERRITT, Petitioners,

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision-Entered June 27, 1963

Pursuant to the opinion of the Court filed October 31, 1962, and the agreed computation of the tax liabilities filed by the parties, it is

Ordered and Decided: That there are deficiencies in income taxes due from the petitioners for the taxable years 1954, 1955, and 1956 in the respective amounts of \$848.48, \$1,532.21, and \$3,373.52; and

That there is a deficiency in addition to the tax under the provisions of section 294(d)(1)(A) of the Internal Revenue Code of 1939 due from the petitioners for the taxable year 1954 in the amount of \$208.50.

W. M. Drennen, Judge.

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision without prejudice to the right of petitioners to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

John Y. Merrell, Counsel for Petitioners.

Crane C. Hauser, Chief Counsel, Internal Revenue Service.

(Seal)

[fol. 1320]

Before the Tax Court of the United States

Docket No. 84123

G. WESLEY MERRITT and FANNIE J. MERRITT, Petitioners,

V.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Becision-Entered June 27, 1963

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed October 31, 1962, respondent filed on May 9, 1963, a computation for entry of decision. On June 26, 1963, at Motions Calendar counsel for petitioners stated he had no objection to respondent's computation. Accordingly, it is:

Ordered and Decided: That there are deficiencies in income taxes due from petitioners for the taxable years 1954 and 1955 in the amounts of \$886.88 and \$1,596.32, respectively;

That there is a deficiency in income tax due from petitioners for the taxable year 1956 in the amount of \$3,317.39, of which amount \$2,842.78 remains unassessed and unpaid; and

That there is an addition to tax under the provisions of section 294(d) of the Internal Revenue Code of 1939 due from petitioners for the taxable year 1954 in the amount of \$231.58.

W. M. Drennen, Judge.

(Seal)

[fol. 1321]

BEFORE THE TAX COURT OF THE UNITED STATES
WASHINGTON

Docket No. 84124

JACK D. MERRITT and WILLA GRAY MERRITT, Petitioners,

v

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision-Entered June 27, 1963

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed October 31, 1962, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1956 in the amount of \$3,531.81.

W. M. Drennen, Judge.

(Seal)

[fol. 1322]

BEFORE THE TAX COURT OF THE UNITED STATES
WASHINGTON

Docket No. 84125

VIRGIL BOWLING and GLADYS BOWLING, Petitioners,

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision—Entered June 27, 1963

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed October 31, 1962, respondent filed on May 9, 1963, a computation for entry of decision. On June 26, 1963, at Motions Calendar counsel for petitioners stated he had no objection to respondent's computation. Accordingly, it is:

Ordered and Decided: That there are deficiencies in income taxes due from petitioners for the taxable years 1955 and 1956 in the amounts of \$90.18 and \$3,342.48, respectively.

W. M. Drennen, Judge.

(Seal)

[fcl. 1323]

BEFORE THE TAX COURT OF THE UNITED STATES
WASHINGTON

Docket No. 84126

James O. Watson, 3rd and Lucy J. Watson, Petitioners,

V.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision—Entered June 27, 1963

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed October 31, 1962,

respondent filed on May 9, 1963, a computation for entry of decision. On June 26, 1963, at Motions Calendar counsel for petitioners stated he had no objection to respondent's computation. Accordingly, it is:

Ordered and Decided: That there are deficiencies in income taxes due from petitioners for the taxable years 1954 and 1955 in the amounts of \$876.84 and \$837.47, respectively.

W. M. Drennen, Judge.

(Seal)

[fol. 1324]

Before the Tax Court of the United States
Docket No. 90766

PARAGON JEWEL COAL COMPANY, INCORPORATED, Petitioner,

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision-Entered June 27, 1963

Pursuant to the opinion of the Court filed October 31, 1962, and the agreed computation of the tax liabilities filed by the parties; and incorporating herein the facts recited in the computation as the findings of the Court, it is

Ordered and Decided: That there is an overpayment in income tax for the taxable year ended September 30, 1955, in the amount of \$32.20, which amount was paid on March 14, 1956, and for which amount a claim for refund was filed on July 31, 1956, which was within the period provided by section 6511(b)(2) of the Internal Revenue Code of 1954; and

That there are deficiencies in income taxes due from the petitioner for the taxable years ended September 30, 1956, and September 30, 1957, in the amounts of \$6,338.04 and \$7,084.45, respectively.

W. M. Drennen, Judge.

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

Leroy Katz, Counsel for Petitioner.

Crane C. Hauser, Chief Counsel, Internal Revenue Service.

(Seal)

[fol. 1325]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONERS' EXHIBIT No. 74

AMOUNT PER TON PAID BY PARAGON JEWEL TO BARE RIDGE COAL COMPANY FROM NOVEMBER 15, 1951 TO SEPTEMBER 30, 1957

November 15, 1951 through February 9, 1952	\$ 4.00
February 11, 1952 through September 30, 1952	4.50
October 1, 1952 through February 28, 1953	4.75
March 1, 1953 through January 4, 1954	4.50
January 5, 1954 through March 30, 1954	4.25
April 1, 1954 through August 31, 1955	4.00
September 1, 1955 through March 30, 1956	4.25
April 1, 1956 through September 30, 1956	4.50
October 1, 1956 through September 30, 1957	4.75

[fol. 1326]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONERS' EXHIBIT No. 86

[fol. 1327]

BRIEF

IN RE:

KYVA MINING COMPANY .

GRUNDY, VIRGINIA

YEARS: 1955 AND 1956

[fol. 1328]

Grundy, Virginia May 16, 1958

District Director of Internal Revenue, Audit Division, Richmond, Virginia.

Dear Sir:

Reference is made to Revenue Agent's report dated November 6, 1957, enclosed with your letter of transmittal dated December 20, 1957, addressed to

KYVA MINING COMPANY (A Partnership) GRUNDY, VIRGINIA

wherein it is proposed to increase taxable income for the calendar years 1955 and 1956 in the following amounts:

YEAR

AMOUNT

1955

\$ 1,670.30 21,645.31

1956

The proposed adjustments are represented by the following:

DESCRIPTION	YEAR	YEAR
1	1955	1956
Percentage Depletion disallowand	e \$1,684.99	\$18,915.84
Depreciation disallowance	402.18	513.29
Long-Term Capital Gain increase	334.62	12:
Income from Coal Sales overstate	d 751.49	
Income from Coal Sales understated		2,216.18
MOM AT THE PROPERTY.	-8-	2,210.10
TOTAL PROPOSED ADJUSTMENTS	\$1,670.30	\$21,645.31
[fol. 1329] The proposed adjustmers pective partners in the following	ents are allong manner:	cated to the
PARTNER	YEAR 1955	YEAR 1956
Virgil Bowling,		14
Grundy, Virginia:	A	
Ordinary Income	\$ 445.23	\$10,822.66
Long-Term Capital Gain	111.54	
G. Wesley Merritt, Louisa, Kentucky:		
Ordinary Income	445.23	3 380
Long-Term Capital Gain	111.54	5,411.32
Jack D. Merritt,	111.01	
Grundy, Virginia:	•	
Ordinary Income		5,411.33
J. O. Watson,		-,
Louisa, Kentucky:		146
Ordinary Income	445.22	
Long-Term Capital Gain	111.54	
TOTAL ALLOCATION	1	
OF PROPOSED		
ADJUSTMENTS	\$1,670.30	\$21,645.31
		-
- 1	1	

Italic figures appear in red on original copy.

STATEMENT OF FACTS

The above named partners who, with their respective wives, filed timely joint income tax returns for the years 1955 and 1956, have been engaged for many years in the mining of coal and related businesses in Virginia and Kentucky and, during the years in controversy, operated the partnership of Kyva Mining Company in Buchanan County, Virginia, under an oral contract with Paragon Jewel Coal Company.

Paragon Jewel Coal Company (hereinafter referred to as "Paragon") leased from the owners all of the coal land involved in this case and obligated itself to pay an annual minimum royalty, tonnage royalty, wheelage, land taxes and extraction taxes. It made substantial improvements necessary for transporting, processing and marketing the coal, including roads, railroad side-trackage and a tipple with processing equipment. Paragon elected not to mine [fol. 1330] the coal underlying its leased boundaries, but entered into oral contracts with several mine operators to conduct the mining operations at their own risk and expense.

During the latter part of the year 1954 a contract was discussed with Paragon's superintendent. After inspecting the property, one or more of the present partners entered into an oral contract to produce coal from a designated area, and, as a result, formed the present partnership of Kyva Mining Company to conduct the operation.

The provisions of the contract were not explicitly stated, but must be determined from the course of conduct of the parties as well as from the fragmentary evidence of their conversations.

The partnership was obliged to extract all mineable coal in the area allocated to it and to deliver the coal at its expense to Paragon's tipple.

The partnership could not sell the coal to anyone else without the permission of Paragon

Paragon agreed to receive and to pay the partnership a o specified price per ton for all coal so mined and delivered.

It was understood, however, that this price might be modified from time to time in accordance with the existing market price of coal.

The contract was for no specific term.

The partnership assumed the full responsibility and expense of operating the mine, in accordance with state and federal mining laws, including all engineering services required.

Paragon was to build and maintain a road from its tipple to a point approximating the partnership's mine head. [fol. 1331] It was agreed that at the conclusion of the operation the partnership might remove its mining equipment, but not any structures or items necessary for the safety of the mine.

At the time the contract was made depletion was not discussed.

Pursuant to the contract, the partnership expended considerable sums in structures and equipment incident to the operation of its mine.

The partnership continued its mining operation under the contract with Paragon without interuption until its affairs were merged into that of Farwest Coal Company, another operating partnership, during the latter part of the year 1957.

The question of the right to terminate the contract never arose between the partnership and Paragon.

ISSUES INVOLVED

The proposed adjustments to taxable income for the years 1955 and 1956 are herein protested in part on the grounds that:

. (a) The Revenue Agent erred in disallowing the percentage depletion deduction for the years 1955 and 1956.

Other issues raised by the Revenue Agent for the years 1955 and 1956 are of little consequence, and are herein conceded.

ARGUMENT

The partnership is entitled to a deduction of percentage depletion under Sections 611 (a) and 613 (b) (4) of the Internal Revenue Code of 1954 if it possessed an economic interest in the coal that it mined, as that term has been [fol. 1332] defined and interpreted by the Courts.

It is well established that the purpose of the depletion allowance is to encourage the exploration of natural resources which are exhausted upon recovery. The allowance is afforded to all who have an economic interest in the mineral.

The partnership's contract with Paragon embraced the following understanding between the partners and Paragon:

- (a) The contract covered a specific area of land and gave the exclusive right to mine all of the merchantable coal from within the designated area.
- (b) The contract required the partnership to conduct its mining operations in a safe manner and in accordance with the State and Federal laws and regulations applicable to coal mining.
- (c) The contract required that the partnership be directly responsible to the State and Federal mining authorities in the conduct of its mining operations.
- (d) The contract required that Paragon furnish the engineering services, and that the partnership pay for such services.
- (c) The contract required that the partnership was to mine the coal in accordance with the maps and directions of the Paragon engineers.
- (f) The contract required that the partnership was to be solely responsible for its mining operation, for the production of the coal and for the delivery of the coal to Paragon's tipple,

(g) The contract required the partnership to provide all of the equipment, labor, power, materials and supplies incident to its mining operation.

[fol. 1333] (h) The contract specified a per ton price for all coal delivered to Paragon's tipple, and this price was to fluctuate in accordance with the market price of coal.

(i) The contract specified the right of termination by either party at any time, but the question never arose between the partnership and Paragon.

As of December 31, 1955 and December 31, 1956, the cost of mining equipment used in the partnership's business was as follows:

December 31, 1955

\$25,576,34

December 31, 1956

36.901.30

The expenses, inclusive of depreciation but exclusive of percentage depletion, of the partnership's business for the years 1955 and 1956 were as follows:

Year 1955

\$ 76,036.64

Year 1956

145,759.58

The economic realities of the situation involved here are that the partners had the responsibility for, and the right to produce, coal from the mineral property in question. They made a very substantial investment in money and time for the production of coal. The recovery of this investment and their rights in the production of coal depended completely upon the extraction, delivery and sale of the mineral.

This case is identical with that of the Stilwell Case (C. W. and Mattie Stilwell and S. W. and Rosie Stilwell v. United States of America), in which the District Court for the Western District of Virginia held for the Government. The United States Court of Appeals for the Fourth Circuit reversed and remanded the case in its decision of December 27, 1957.

[fol. 1334] The Stilwell mine is located adjacent to or near that of the partnership's mine, and is operated under an oral contract from Paragon setting out the identical terms and conditions as that specified in the instant case. If the Stilwell operation is to be allowed percentage depletion (and the Fourth Circuit has so ruled) and the partnership operation denied percentage depletion, we will have the ironic situation of two similar operations in the same area and operating under identical terms and conditions receiving different tax treatment. One contractor of Paragon, as in the Stilwell case, will be allowed depletion, but another contractor of Paragon will be denied depletion, even though his operation is the same, his responsibilities are the same, and his compensation is the same.

GENERAL

It is respectfully requested that this case be transferred to the Appellate Division of the District Commissioner's Office, and that an oral hearing be arranged at a time mutually convenient to that office and the taxpayer's representatives.

Power of attorney, in the name of the writer of this brief, is on file in your office.

Respectfully submitted,

Kyva Mining Company
By: /s/ G. Wesley Merritt
Partner

[fol. 1335]

STATE OF VIRGINIA

TOWN OF GRUNDY

Personally appeared before me, a Notary Public for the state and town aforesaid, G. Wesley Merritt, who, upon being duly sworn; stated that he is one of the partners mentioned in the foregoing brief; that he has read the brief in

its entirety; and that, to the best of his knowledge and belief, the statements made therein are true.

Given under my hand, this the 19th day of May, 1958.

/s/ JEAN B. DENNIS Notary Public

My commission expires Feb. 25 1961.

(Seal)

ENROLLED AGENT'S CERTIFICATE

I, C. J. Stull, an enrolled agent, have prepared the foregoing brief and, based upon my examination of the accounts and the information furnished to me, the statements made therein are known or believed to be true.

> /s/ C. J. STULL C.P.A. (Va.) Enrolled Agent

[fol. 1336]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONERS' EXHIBIT No. 87

[fol. 1337]

BRIEF

IN RE:

STANDARD SMOKELESS COAL COMPANY

GRUNDY, VIRGINIA

YEARS: 1954, 1955 AND 1956

[fol. 1338]

Grundy, Virginia May 16, 1958

District Director of Internal Revenue, Audit Division, Richmond, Virginia.

Dear Sir:

Reference is made to Revenue Agent's report dated November 4, 1957, enclosed with your letter of transmittal dated December 20, 1957, addressed to

STANDARD SMOKELESS COAL COMPANY (A Partnership) GRUNDY, VIRGINIA

wherein it is proposed to increase taxable income for the calendar years 1954, 1955 and 1956 in the following amounts:

*	
YEAR	 AMOUNT
1954	\$ 6,314.17
1955	16,444.58
1956	 21,210.46

The proposed adjust lowing:	tments are 1		
DESCRIPTION	1954	YEAR 1955	YEAR 1956
Percentage Depletion disallowance	\$6,314.17	\$15,334.78	\$13,836.76
Income from Coal Sales understated		1,109.80	662.03
Deferred Income disallowed			6,711.67
TOTAL PROPOSED		**	
Adjustments	\$6,314.17	\$16,444.58	\$21,210.46
[fol. 1339] The propos respective partners in t	ed adjustme he following	nts are alloc manner:	eated to the
PARTNER	YEAR 1954	YEAR 1955	YEAR 1956
Robert Lee Merritt,	/ .		
Grundy, Va:	1.		*
Ordinary Income	\$2,104.72	\$ 5,481.52	\$10,605.24
G. Wesley Merritt,			
Louisa, Ky:			
Ordinary Income	2,104.73	5,481.54	5,302.61
J. O. Watson, Louisa, Ky:			
Ordinary Income	2,104,72	5,481.52	
Jack D. Merritt, Grundy, Va:	•	0,101.02	
Ordinary Income	7		5,302.61
TOTAL ALLOCATION	\$6,314.17	\$16,444.58	\$21,210.46

STATEMENT OF THE FACTS

The above named partners who, with their respective wives, filed timely joint income tax returns for the years 1954, 1955 and 1956, have been engaged for many years (with the exception of Jack D. Merritt, who came into the partnership in 1956) in the mining of coal and related businesses in Virginia and Kentucky and, during the years in controversy, operated the partnership of Standard Smokeless Coal Company in Buchanan County, Virginia, under an

oral contract with Paragon Jewel Coal Company.

Paragon Jewel Coal Company (hereinafter referred to as "Paragon") leased from the owners all of the coal land involved in this case and obligated itself to pay an annual minimum royalty, tonnage royalty, wheelage, land taxes and extraction taxes. It made substantial improvements necessary for transporting, processing and marketing the coal, including roads, railroad side-trackage and a tipple with processing equipment. Paragon elected not to mine the coal underlying its leased boundaries, but entered into oral contracts with several mine operators to conduct the [fol. 1340] mining operations at their own risk and expense.

During the month of June in the year 1953, Robert Lee Merritt, one of the aforementioned partners, came to Virginia for the purpose of discussing a contract with Paragon's superintendent. After inspecting the property and satisfying himself with regard to the merits of the venture, he entered into an oral contract to produce coal from a designated area and, as a result, formed the present partnership of Standard Smokeless Coal Company to conduct the operation.

The provisions of the contract were not explicitly stated, but must be determined from the course of conduct of the parties as well as from the fragmentary evidence of their conversations.

The partnership was obliged to extract all mineable coal in the area allocated to it and to deliver the coal at its expense to Paragon's tipple.

The partnership could not sell the coal to anyone else without the permission of Paragon.

Paragon agreed to receive and to pay the partnership a specific price per ton for all coal so mined and delivered.

It was understood, however, that this price might be modified from time to time in accordance with the existing market price of coal.

The contract was for no specific term.

The partnership assumed full responsibility and expense of operating the mine, in accordance with State and Federal mining laws, including all engineering services required.

Paragon was to build and maintain a road from its tipple to a point approximating the partnership's mine head.

It was agreed that at the conclusion of the operation the [fol. 1341] partnership might remove its mining equipment, but not any structures or items necessary for the safety of the mine.

At the time the contract was made depletion was not discussed.

Pursuant to the contract, the partnership expended considerable sums in structures and equipment incident to the operation of its mine.

The partnership has continued its mining operation under its contract with Paragon without interruption.

The question of the right to terminate the contract has never arisen between the partnership and Paragon.

ISSUES INVOLVED

The proposed adjustments to taxable income for the years 1954, 1955 and 1956 are herein protested in part on the grounds that:

(a) The Revenue Agent erred in disallowing the percentage depletion deduction for the years 1954, 1955 and 1956.

Other issues raised by the Revenue Agent for the years 1955 and 1956 are herein conceded.

ARGUMENT

The partnership is entitled to a deduction of percentage depletion under Sections 611 (a) and 613 (b) (4) of the Internal Revenue Code of 1954 if it possessed an economic interest in the coal that it mined, as that term has been defined and interpreted by the Courts.

It is well established that the purpose of the depletion allowance is to encourage the exploration of natural resources which are exhausted upon recovery. The allow-[fol. 1342] ance is afforded to all who have an economic interest in the mineral.

The partnership's contract with Paragon embraced the following understanding between the partners and Paragon.

- (a) The contract covered a ceific area of land and gave the exclusive right to mine 'l' of the merchantable coal from within the designated area.
- (b) The contract required the partnership to conduct its mining operations in a safe manner and in accordance with the State and Federal laws and regulations applicable to coal mining.
- (c) The contract required that the partnership be directly responsible to the State and Federal mining authorities in the conduct of its mining operations.
- (d) The contract required that Paragon furnish the engineering services, and that the partnership pay for such services.
- (e) The contract required that the partnership was to mine the coal in accordance with the maps and directions of the Paragon engineers.
- (f) The contract required that the partnership was to be solely responsible for its mining operation, for the production of the coal and for the delivery of the coal to Paragon's tipple.

- (g) The contract required the partnership to provide all of the equipment, labor, power, materials and supplies incident to its mining operation.
- (h) The contract specified a per ton price for all coal delivered to Paragon's tipple, and this price was to fluctuate in accordance with the market price of coal.
- (i) The contract specified the right of termination by either party at any time, but the question has never arisen between the partners and Paragon.

[fol. 1343] As of December 31, 1954, December 31, 1955 and December 31, 1956, the cost of mining equipment used in the partnerships' business was as follows:

December 31, 1954		\$18,939.46	KYVA
December 31, 1955	1	° 29,440.24	\$25,576.34
December 31, 1956		33,263.81	26,901.30

The expenses, inclusive of depreciation but exclusive of percentage depletion, of the partnerships' business for the years 1954, 1955 and 1956 were as follows:

YEAR	STANDARD	KYVA
1954	\$73,214.02	
1955	117,313.42	\$76,036.64
1956	99,910.70	145,759.58

The economic realities of the situation involved here are that the partners had the responsibility for, and the right to produce, coal from the mineral property in question. They made a very substantial investment in money and time for the production of coal. The recovery of this investment and their rights in the production of coal depended completely upon the extraction, delivery and sale of the mineral.

This case is identical with that of the Stilwell Case (C. W. and Mattie Stilwell and S. W. and Rosie Stilwell v. United States of America), in which the District Court for the

Italic figures are pencilled notations on original copy.

Western District of Virginia held for the Government. The United States Court of Appeals for the Fourth Circuit reversed and remanded the case in its decision of December 27, 1957.

The Stilwell mine is located adjacent to that of the partnership's mine, and is operated under an oral contract from [fol. 1344] Paragon setting out the identical terms and conditions as that specified in the instant case.

If the Stilwell operation is to be allowed percentage depletion (and the Fourth Circuit has so ruled) and the partnership operation denied percentage depletion, we will have the ironic situation of two similar operations adjacent to one another and operating under identical terms and conditions receiving different tax treatment. One contractor of Paragon, as in the Stilwell case, will be allowed depletion, but another contractor of Paragon will be denied depletion, even though his operation is the same, his responsibilities are the same, and his compensation is the same.

GENERAL

It is respectfully requested that this case be transferred to the Appellate Division of the District Commissioner's Office, and that an oral hearing be arranged at a time mutually convenient to that office and the taxpayer's representatives.

Power of attorney, in the name of the writer of this brief, is on file in your office.

Respectfully submitted,

STANDARD SMOKELESS COAL COMPANY By: /s/ G. WESLEY MERRITT, Partner

[fol. 1345]

STATE OF VIRGINIA)

TOWN OF GRUNDY

Personally appeared before me, a Notary Public for the state and town aforesaid, G. Wesley Merritt, who, upon being duly sworn, stated that he is one of the partners men-

tioned in the foregoing brief; that he has read the brief in its entirety; and that, to the best of his knowledge and belief, the statements made therein are true.

Given under my hand, this the 19th day of May, 1958.

/s/ JEAN B. DENNIS Notary Public

My commission expires Feb. 25, 1961.

(Seal)

ENROLLED AGENT'S CERTIFICATE

I, C. J. Stull; an enrolled agent, have prepared the foregoing brief and, based upon my examination of the accounts and the information furnished to me, the statements made therein are known or believed to be true.

> /s/ C. J. STULL, C.P.A. (Va.) Enrolled Agent

[fol. 1346]

BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONERS' EXHIBIT No. 98

Adm. 158 (5/57)

UNITED STATES DEPARTMENT OF LABOR Washington, D. C.

ATTESTATION

I, Hereby Attest, that the attached document, Wholesale Price Indexes for Subgroups and Product Classes—Fuel, Power and Lighting Materials—Coal (1947-49 = 100) January 1947 to August 1957, is a true copy, which is in the official records of the United States Department of Labor, Bureau of Labor Statistics.

Signed at Washington, D. C., 11 day of October, 1957.

(Acting) /s/ W. Duane Evans
Commissioner of Labor Statistics

CERTIFICATE

I, HEREBY CERTIFY, that W. Duane Evans, who signed the foregoing attestation, is now and was at the time of signing the Acting Commissioner of Labor Statistics, and that full faith and credit should be given to his acts as such.

IN WITNESS THEREOF, I, James E. Dodson, duly designated by the Secretary of Labor as Authentication Officer of the Department of Labor, have hereunto subscribed my name and caused the seal of the Department of Labor to be affixed this 11 day of October, 1957.

[Seal]

/s/ James E. Dorson
Authentication Officer
United States Department of Labor

U.S. DEPARTMENT OF LABOR Division of Prices and Cost of Living Washington 25, D. C.

WHOLESALE PRICE INDEXES FOR SUBGROUPS AND PRODUCT CLASSES FUEL, POWER AND LICHTING TATELLAIS - CCALS (1947-49=100)

	05-1	: 05-11	: 05-12	05-12-01
Year and :	Coal	: Pennsylvania	: Bituminous Coal :	*bituminous Coal
1956				•
r. Avg.	114.5	123.8	112.6	115.1
Jan.	109.0	120.0	106.7	116.7
eb.	109.9	126.0	106.7	116.6
ar.	110.1	128.0	107.0	111,.0
pr.	111.7	115.1	110.7	107.1
23	111.9	115.1	111.0	107.9
June	112.3	115.1	111.5	109.8
July	112.9	113.8	111.6	111.
ug.	113.8	116.5	112.6	111,14
ept.	114.4	120.3	113.0	. 11/.4
Oct.	121.0	125.3	119.9	122.9
lov.	122.0	131.6	120.1	123.7
Dec.	123.5	11,2.0	120.2	124.0
4"				124.0
1957	//			1- 15
r. Avg.	1. "			
Jan	124.1	142.0	120.3	121.1
'eb.	121,.0	142.0	120.8/	124.1
far.	123.6	112.0	120.3	121.4
pr.	123.2	128.9	121.8	1 115.5
iay	123.3	123.9	121.9	116.1
lune	123.3	1 128.9	122.0	117.2
July	121,.0	132.3	122.3	119.1
ug.	12/1./1	132.7	122.6	121.2
Bept.		~,	12.00	75.696

Division of rices and Cost of Living washington 25, D. C.

WHOLESALE PRICE INDEXES FOR SUBGROUPS AND PRODUCT CLASSES FUEL, POWER AND LIGHTING TATABLE IS - CCALS (1947-49-100)

	05-1	:	05-11	1	05-12		05-12-01
Year and :		:	Pennsylvania	: \$			*bituminous Coal
.ionth :	Coal	1	anthracite	: 35	tuninous	Coal :	· Domestic Sizes
1956	*1		*,		3.5° V	est.	•
Yr. Avg.	114.5		123.8	٠	112.6		115.4
Jan.	109.0		123.0		106:7		116.7
Peo.	109.9		126.0		106.7		116.6
ar.	110.1	7	128.0		107.0		111:0
Apr.	111.7	•.	115.1		0 110.7		107.1
ay .	111.9		115.1		111.0		107.9
June	112.3		115.1		111.1		109.8
July	112.9		113.8		111.6		111.1
iug.	113.8		113.8		112.6		11/1.4
Sept.	111:01		120.3		113.0		116.4
Oct.	121.0	. :	125.3		119.9		122.9
ov.	122.0	- 1	131.6		120.1	y .	123.7
Dec.	123.5		11,2.0		120.2		124.0
			1 3				124.0
1957		1					
r. hvg.							
Jan	124.1		11,2.0		120.5	ak .	124.1
reb.	121.0	,	142.0		120.8		124.1
far,	123.6		142.0		120.3	,	121.4
pr.	123.2		126.9	-	121.8	. "	115.5
iay	123.3		128.9		121.9	+	116.1
June	123.3		128.9		122.0		117.2
July	121,00		132.3		122.3		119.1
ug.	121111		132.7	- 0	122.6		121.2
Sept.	. 7			4			16.1.05
ct.					-		
lov.				3.	. /		,
Dec.						- 1	

^{*}January 1947 through April 1954, Prepared Sizes (Code U5-12-U1). Beginning May 1954 special index of Domestic Sizes (Codes O5-12-O4 and O5-12-O5).

U.S. DEPARTMENT OF LABOR Bureau of Labor Statistics Division of Prices and Cost of Living Washington 25, D. C.

WHOLESALE PRICE INDEXES FOR SUBGROUPS AND PRODUCT CLASSES FUEL, POWER AND LIGHTING MATERIALS - COAL (1947-49=100)

		(2)47-47-20		14.
	05-1	: 05-11	:05-12	: 05-12-01
Year and :		: Pennsylvania		: *Bituminous Coal
Month:	Coal	: Anthracite	: Bituminous Coal	: Domestic Sizes
1953				
Yr. Avg.	112.8	138.6	103.4	111.3
Jan.	116.3	141.3	112.0	117.1
Feb.	115.9	141.3	111.6	116.8
Mar.	114.4	141.4	109.8	113.4
Apr.	111.2	133.2	107.5	106.6
May	110.8	133.2	107.0	106.4
June	111.2	135.3	107.1	107.4
July '	111.8	137.9	107.4	108.7
Aug.	111.7	139.5	106.9	110.2
Sept.	112.3	141.1	107.3	111.1
Oct.	112.5	139.4	107.9	112.6
Nov.	112.5	139.6	107.9	112.6
Dec.	112.5	139.6	107.9	112.5
2051		1		
1954 Yr. Avg.	106.3	128.6	100 4	
Jan.	111.9		. 102.4	108.8
Feb.	110.9	139.6	107.1	113.0
Mar.	107.9	139.6	106.0	112.2
Apr.	104.1	139.6	102.5	106.3
May	104.6	120.2	101.4	103.7
June	104.7	124.6	101.2	103.6
July	104.9	126.3	101.1	103.6 107.2 106.7 108.5
Aug.	105.2	126.3	101.2	106.7
Sept.	105.5	127.1	101.5	108.5
Oct.	105.1	127.1	101.8	110.8
Nov.	105.1	123.5	101.9	112.1
Dec.	105.2	124.4	101.8	112.3
	107.2	125.4	101.7	112.2
1955 r. Avg.			•//	1 - 1
r. Avg.	104.8	120.8	102.0	110.2
Jan.	105.2	126.0	101.7	112.2
eb.	105.2	126.0	101.6	112.1
far.	105.1	126.0	101.5	111.8
pr.	102.3	126.0	98.4	102.7
lay	100.4	112.8	98.1	102.8
une	100.6	112.8	98.4	103.6
1.	207/1	7720	100/0	100 2

- 1	05-1	05-11	: 05-12	05-12-01
Year and :		Pennsylvania		*Bituminous Coa
Month:	Coal	Anthracite	: Bituminous Coal	: Domestic Size
1953				1 . 1 .
r. Avg.	112.8	138.6	100 /	111.3
an.	116.3	141.3	103.4	117.1
eb.	115.9	141.3	111.6	116.8
lar.	114.4	141.4	109.8	
pr.	111.2	133.2		113.4
lay	110.8		107.5	106.6
une	111.2	133.2	107.0	106.4
uly	111.8	0. 135.3	107.1	107.4
		137.9	107.4	108.7
ug.	111.7	139.5	106.9	110.2
Sept.	112.3	141.1	107.3	111.1
et.	112.5	139.4	107.9	112.6
lov.	112.5	139.6	107.9	112.6
Dec.	112.5	139.6	107.9	112.5
1954			0	
r. Avg.	106.3	128.6	102.4	108.8
an.	111.9	139.6	107.1	113.0
eb.	110.9	139.6	106.0	112.2
ar.	107.9	139.6	102.5	106.3
pr.	104.1	120.2	101.4	
lay	104.6	124.6	101.2	103.7
une	104.7	126.3		103.6
uly	104.9	126.3	101.1	10/.2
uz.	105.2	120.3	101.2	106.7
ept.	105.5	127.1	101.5	108.5
et.		127.1	101.8	110.8
9 -	105.1	123.5	101.9	112.1
ov.	105.1	124.4	101.8	112.3
ec.	105.2	125.4	101.7	112.2
1955	201 0	12.00		
r. Avg.	104.8	120.8	102.0	110.2
	105.2	126.0	101.7	112.2
eb. /	105.2	126.0	101.6	112.1
er.	105.1	126.0	101.5	111.8
bar	102.3	126.0	98.4	102.7
sy _	100-4	112.8	98.1	102.8
ine	100.6	112.8	98.4	103.6
ily	101.5	115.8	99.0	106.3
ug.	102.2	115.8	99.7	108.7
ept.	108.1	117.7	106.3	114.6
st.	108.7	122.6	106.1	115.7
ov.	100.0	1 123.0	106.4	116.0
BC.	109.1	12h.9 054, Prepared \$170	106.6	116.3

U.S. DEPARTMENT OF LABOR Bureau of Labor Statistics Division of Prices and Cost of Living Washington 25, D. C.

WHOLESALE PRICE INDEXES FOR SUBGROUPS AND PRODUCT CLASSES FUEL, POWER AND LIGHTING MATERIALS - COAL* (1947-49=100)

	-05-1 B	: 05-11	: 05-12	: 05-12-01
Year and :	, ,	: Pennsylvania	. :	: **Bituminous Coal
Month:	Coal	: Anthracite	: Bituminous Coal	: Domestic Sizes
1950	21	1		
Yr. Avg.	106.2	110.6	105.5	110.0
Jan.	107.0	107.6	107.0	111.7
Feb.	107.6	107.6	107.6	113.0
Mar.	109.0	110.2	108.8	114.5
Apr.	105.7	111.0	104.8	106.9
May	104.7	107.8 %	104.2	106.5
June	104.8	108.8	104.1	106.8
July	105.1	109.7	104.3	107.5
Aug.	105.6	111.1	104.6	108.8
Sep.	106.1	112,2	105.0	110.1
Oct.	106.3	113.1	105.2	111.2
Nov.	106.3	. 114.1	105.0	111.2
Dec.	105.3	114.5	105.0	
1951				111.3
Yr. Avg.	108.4	123.0	105.9	110.0
lan.	106.5	115.2	105.0	111.1
eb.	110.6	124.7.	103.2	114.1
Mar.	110.1	124.7	107.6	112.7
Apr.	108.2	121.2	105.9	107.0
May	107.8	120.3	105.6	106.9
June	108.1	121.9	105.7	107.4
July	107.2	123.0		
Aug.	107.5	124.0	104.5	107.7
Sept.	108.4	125.2	104.6	108.5
Oct. /	106.7		105.5	110.1
Nov.	108.8	125.2	105.8	110.8
		125.2	106.0	111.4
Dec. 1952	108.9	/125.2	106.1	111.7
r. Avg.	108.7	124.8	105.9	110.0
an.	108.8	125.2	106.0	111.7
bb.	108.8	125.2	106.0	
iar.	108.7	125.2	105.8	111.6
pr.	104.9	117.5.	102.8	10/ 7
lay	104.9	1 / 117.9.	102.7	104.7
une	105.3	119.0	102.9	104.2
uly	106.0	120.6		105.2
	1	120.0	103.5	107.0

[fol. 1349

(1947-49=100)

	05-1	: 05-11	05-12	: 05-12-01
Year and :		: Pennsylvania	· de	: **Bituminous Coal
Month	Coal	: Anthracite	; Bituminous Coal	: Domestic Sizes
1950		. 0.		1 10/6
r. Avg.	106.2	110.6	105.5	110.0
an.	107.0	107.6	107.0	111.7
eb.	107.6	107.6	107.6	113.0
far.	109.0	110.2	108.8	114.5
pr.	105.7	111.0	104.8	106.9
lay	104.7	107.8	104.2	106.5
une	104.8	108.8	104.1	106.8
uly	105.1	109.7	104.3	107.5
ug.	105.6	111.1	104.6	108.8
Sept.	106.1	112.2	105.0	110.1
ct.	106.3	113.1	105.2	111.2
lov.	. 106.3.	114.1	105.0	111.2
lec.	106.3	114.5	105.0	111.3
1951	. 200.7		103.0	
r. Avg.	108.4	123.0	105.9	110.0
an.	106.5	115.2	105.0	111.1
eb.	110.6			
	110.1	124.7	103.2	114.1
ar.		124.7	107.6	112.7
pr.	108.2	121.2	105.9	107.0
ay	107.8	120.3	105.6	106.9
une	108.1	121.9	105.7	107.4
uly	107.2	123.0.	104.5	107.7
ug.	107.5	124.0	104.6	108.5
ept.	108.4	125.2.	105.5	110.1
ct.	106.7	125.2	105.8.	110.8
ov.	108.8	125.2	106.0	111.4
ec.	108.9	125.2	106.1.	111.7
1952		12 17 11 15	. // 1	
r. Avg.	108.7	124.8	105.9	110.0
an.	108.8	125.2	106.0.	111.7
eb.	108.8	125.2	106.0	111.6
ar.	108.7	125.2	105.8	111.2
pr.	104.9	117.5	102.8	104.7
ay	104.9	117.9.	102.7	104.2
une	104.9	119.0.	102.9	105.2
uly	106.0	120.6	103.5	107.0
ug.	106.5	122,4	103.7	107.9
ept.	107.6	124.5.	104.7	110,1
ct.	113.3	129.4	110.5	114.6
ov.	113.6	129.4.	110.9	
ec.	116.1	141.3	111.8	114.7
			or to January 1952.	The only offi-

*This does not replace the official index prior to January 1952. The only official index up to and including December 1951 is the former index series (1926=100).

**January 1947 through April 1954, Prepared Sizes (Code 05-12-01). Beginning May 1954 special index of Domestic Sizes (Codes 05-12-04 and 05-12-05).

[fol. 1350]

U.S. DEPARTMENT OF LABOR Bureau of Labor Statistics Division of Prices and Cost of Living Washington 25, D. C.

WHOLESALE PRICE INDEXES FOR SUBCROUPS AND PRODUCT CLASSES FUEL, POWER AND LIGHTING MATERIALS - COAL* (1947-49=100)

	05-1	05-11	05-12	: 05-12-01
Year and :	Coel	: Pennsylvania ::		: **Bituminous Coa
1947	COST	: Anthracite :	Bituminous Co	al : Domestic Size
Yr. Avg.	88.0	91.2	000	• • • •
Jan.	78.2	33.9	37.4	86.9
Feb.	78.3	88.2	76.4	76.8
lar.	78.4	83.2	76.6	77,0
Apr.	78.7	86.8	76.7	77.0
May	78.7	85.3	77.3	77.4
June	79.1	65.9	77.6	77.5
July	92.1	86.6	78.0	77.6
Aug.	97.4		+ 93.1	91.8
Sinc.	98.0	96.0 97.0	97.6	96.1
Ocu.	98.7		98.2.	96.6
Nov.	99.0	97.1	99.0	97.4
Dec.	99.3	97.1	99.3	98.3
1948	77.7	97.1	99.7	99.4
Yr. Avg.	106.2	102.4	2010	5
Jan.	100.0		106.9	106.2
eb.	100.1	97.1	100.5	100.0
far.	100.1	97.1	100.6	100.3
Apr.	100.9	97.1 97.1	100.6	100.4
lay	102.4	97.1	101.5	100.8
lune	102.9	97.3 98.5	103.2	101.9
luly	110.9	104.3	103.6	102.8
lug.	111.6	100 0	112.0	. 111.1
ept.	111.6	108.0	112.2	111.6
ct.	111.4	108.0	112.2	111.7
iov.	111.3	100.0	141.9	111.4
ec.	111.3	108.0	111.9	111.5
/ 1949		100.0	111.9	111.51
r. Ayg.	105.8	106.4	105 0	
an.	110.7	103.0	105.7	106.9
eb.	110.3	103.0	111.1	110.9
ar.	108.7	108.0	110.7	110.5
pr.	104.8	105.3	108.9	109.4
ay	103.8	103.6	104.7	104.7
une	103.7	710.0	103.8	103.8
uly	103.9	104.4	103.6	104.4
ue.	104.0	104.8	103.8	105.0

	05-1	05-11	05-12	05-12-01
Year and :		: Pennsylvania		: "Bituminous Coa
Menth :	Coal	Anthracite	: Bituminous Co	1 : Domestic Size
1917				
T. AVE.	88.0	91.2	37.4	86.97
an.	76.2	33.9	76.4	76.8
eb.	78.3	88,2	76.6	77.0
er.	78.4	83.2	76.7	77.0
pr.	78.7	86.8	77.3	77.4
ay	78.7	85.3	77.6	77.5
une	79.1	85.9	78.0	77.6
uly	92.1	86.6	93.1	91.8
ug.	97.4	96.0	97.6.	96.1
105. 4	98.0	97.0	98.2	96.6
cu.	98.7	97.1	99.0	97.4
ov,	99.0	97.1	99.3	98.3
ec.	99.3	97.1	99.7	199.4
1948				//
r. Avg.	106.2	. 102.4	206.9	106.2
an.	2100.0	97.1	100.5	100.0
eb.	100.1	97.1	100.6	100.3
ar.	100.1	97.1	100.6	100.4
pr.	100.9	97.1	101.5	100.8
ay	102.4	97.3		101.9
une	102.9	98.5	103.2	
uly	110.9	104.3	103.6	102.8
ug.	111.6	107.9		. 111.1
ept.	111.6		112.2	111.6
ct.		108.0	112.2	111.7
	111.4	108.0	111.9	111.4
ov.	111.3	108.0	111.9	111.5
BC.	111.3	108.0	111.9	111.5
1949	105.4			
r. Avg.	105.8	106.4	105.7	106.9
an.	110.7	103.0	111.1	110.9
eb.	110.3	100.0	110.7	110.5
ar.	108.7	108.0	108.9	109.4
r.	104.8	105.3	104.7	104.7
y	103.8	103.6	103.8	103.8
ine	103.7	104.4	103.6	104.4
ıly	103.9	104.8	103.8	105.0
ıg	104.0	105.9	103.6	105.2
pt.	104.1	106.9	103.6	- 105.7
t.	104.3	107.6	103.7	105.9
V	105.4	107.6	105.0	107.8
C	106.2	107.6	106.0	109.2

*This does not replace the official index prior to January 1952. The only official index up to and including December 1951 is the former index series (1926-100).
**January 1947 through April 1954, Prepared Sizes (Code 05-12-01). Beginning
| May 1954 special index of Domestic Sizes (Codes 05-12-04 and 05-12-05).

[fol. 1352

IN UNITED STATES COURT OF APPRALS

FOR THE FOURTH CIRCUIT

No. 9179

ROBERT LEE MERRITT and WINNIE MERRITT; OR WESLEY
MERRITT and FANNIE J. MERRITT; JACK D. MERRITT
and WILLA GRAY MERRITT; VIRGINIA BOWLING and GLADYS
BOWLING, and JAMES O. WATSON, 3RD, and LUCY J.
WATSON, Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent,

and

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

versus

PARAGON JEWEL COAL COMPANY, Inc., Respondent.

On Petitions to Review the Decisions of the Tax Court of the United States.

Argued January 13, 1964

Before HAYNSWORTH, BRYAN and J. SPENCER BELL, Circuit Judges.

[fol. 1352] John Y. Merrell for Petitioners, Taxpayers; Michael Mulroney, Attorney, Department of Justice (Louis F. Oberdorfer, Assistant Attorney General, and Lee A. Jackson and Melva M. Graney, Attorneys, Department of Justice, on brief) for Commissioner of Internal Revenue, and Frederick Bernays Wiener (Leroy Katz and Carl C. Gillespie on brief) for Respondent, Paragon Jewel Coal Co., Inc.

Opinion-Entered March 17, 1964

J. SPENCER BELL, Circuit Judge:

These are consolidated appeals from the Tax Court. The issue is whether the lessee, Paragon Jewel Coal Company,

Inc. [hereinafter referred to as Paragon], is entitled to the entire depletion deduction on the coal mined from its leased property or whether the several contract mine operators, petitioners in this action [hereinafter referred to as the operators], are entitled to a part of that depletion deduction based upon the amounts received by them respectively for the coal which each of them mined under agreements with Paragon. The Tax Court, which heard the cases together, decided that the lessee, Paragon, was entitled to the entire percentage depletion deduction. The operators appeal, contending that Paragon is required to share the deduction with them. The Commissioner, who took a neutral position as between the petitioners and Paragon before the Tax Court, appeals the decision in Paragon's case in order to protect his position as a stakeholder, conceding that either the operators or the lessee is entitled to the deduction, but not both.

Since the Commissioner concedes that either the operators or the lessee, Paragon, is entitled to the deduction, we [fol. 1353] find it unnecessary to go into all of the factual. background, but shall confine ourselves to that part which we consider relevant to a decision of the ssue between the parties. Paragon is the assignee of certain leases of coal bearing lands under which it has paid minimum royalties, tonnage royalties and land taxes. It has made substantial. investments on the properties in order to prepare itself to process, ship and market the coal which was produced. Paragon's experience was as a processor and seller of coal rather than a producer; furthermore it lacked the capital to go into the producing end of the business. Rather than mine the coal itself it entered into oral agreements with the petitioning operators and others to mine the coal by a method known as drift mining.1 In addition to the equipment necessary for storing and processing the coal, Paragon installed a road running around the mountain close to the outcrop line of the coal over which the coal could be trucked

Drift mining is done by driving a horizontal shaft into the hillside in order to extract the coal from seams which are usually less than three feet in thickness. The process is a difficult and economically marginal operation.

from the mines to Paragon's tipple, where Paragon cleaned, sized and sold the coal.

Beginning with the Stilwells in 1951 (who are not petitioners here), Paragon entered into oral leases with a number of operators, all of which were similar in ferms. Under the agreement an operator would be allocated a specific surface area under which it might mine. The allocation was made either by pointing it out on the ground or by showing it to him on the over-all property map. The operator agreed to mine the coal within that area and deliver it to Paragon at the operator's own expense. All expenses of opening and operating the mines were borne by the several operators. Paragon agreed to pay a fixed price at the tipple, but it was understood that the price [fol. 1354] would, and in fact it did, vary with the market. The operators were required to use and pay for the services of Paragon's engineer and to operate and maintain their mines in accordance with state and federal regulations. The contracts were silent as to who was entitled to depletion. They contained no termination date and nothing was said between the parties on this subject. The Tax Court found that:

It was anticipated by both parties that a contractor [contract mine operator] would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications.

Because the contracts did not contain a specific statement that they were not terminable at the will of Paragon and because they did not contain a specific statement that the operator had a right or obligation to mine to exhaustion, the Tax Court concluded that as a matter of law the operators did not under the contracts have such rights.

We must disagree with the Tax Court's conclusions of haw. Its own findings as to the intent of the parties quoted above negates its conclusions as to the legal rights of the parties under the contract. The parties contemplated that the operators would, and the evidence shows that they did,

engage in large expenditures of time and money in preparing their respective sites for mining. We think the Tax Court was in error in concluding that because the oral contracts were silent on the point, the operators did not possess a non-terminable right to mine to exhaustion, especially in the face of the court's finding of an intent on [fol. 1356] the part of the parties to the contrary. It would be inequitable indeed to hold that Paragon might remain silent on this point until the operators had invested their time and money and then take the benefit of the operators' efforts at will and without cause. The burden was on Paragon to express the limitation, if any. Jack's Cookie Co. v. Brooks, 227 F.2d 935 (4 Cir. 1955), cert. denied, 351 U.S. 908 (1956). Paragon was under obligation to mine the property. These operators were performing Paragon's obligation under its leases and this constituted ample consideration running from the operators to Paragon to make their mutual intentions with respect to the contract binding on Paragon. The fact that the contracts did not fix upon the operators an obligation to mine to exhaustion does not vitiate the binding effect of the intent of the parties to vest in the operators a right to mine to exhaustion. That the operators could cease mining would not destroy the mutuality. Phillips Petroleum Co. v. Buster, 241 F.2d 178 (10 Cir.), cert. denied, 355 U.S. 816 (1957).

Thus we see under this interpretation of the contracts, the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith, 359 U.S. 215 (1959); Elm Dev. Co. v. Commissioner, 315 F.2d 488 (4 Cir. 1963); and Stilwell v. United States, 250 F.2d [fol. 1356] 736 (4 Cir. 1957). The Tax Court's decisions are reversed and the cases remanded for entry of an order in conformity with this opinion.

Reversed and Remanded.

Indeed the Stilwell case arose out of the same facts, although of course the record being different, it is not res judicata.

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[fol. 1357] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT No. 9179

ROBERT LEE MERRITT and WINNIE MERRITT; G. WESLEY MERRITT and FANNIE J. MERRITT; JACK D. MERRITT and WILLA GRAY MERRITT; VIRGINIA BOWLING and GLADYS BOWLING, and JAMES O. WATSON, 3RD, and LUCY J. WATSON, Betitioners,

·VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent,

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

VS.

PARAGON JEWEL COAL COMPANY, INC., Respondent.

On Petitions to Review the Decisions of the Tax Court of the United States.

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

JUDGMENT-March 17, 1964

On consideration whereof, It is now here ordered and adjudged by this Court that the decisions of the said. Tax Court of the United States, in this cause, be, and the same are hereby, reversed; and that this cause be, and the same is hereby, remanded to the Tax Court of the United States for the entry of an order in conformity with the opinion of the Court filed herein.

Clement F. Haynsworth, Jr., United States Circuit Judge; Albert V. Bryan, United States Circuit Judge; J. Spencer Bell, United States Circuit Judge.

[fol. 1358] Clerk's Certificate (omitted in printing).

[fol. 1359]

No. —, October Term, 1963

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

ROBERT LEE MERRITT, et al.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—June 11, 1964

Upon Consideration of the application of counsel for petitioner,

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 15, 1964.

Earl Warren, Chief Justice of the United States.

[fol. 1360]

Supreme Court of the United States No. 134, October Term, 1964

PARAGON JEWEL COAL COMPANY, INC., Petitioner,

COMMISSIONER OF INTERNAL REVENUE.

ORDER ALLOWING CERTIORARI-October 12, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied, the petition shall be treated as though filed in response to such writ. [fol. 1361]

SUPREME COURT OF THE UNITED STATES
No. 237, October Term, 1964

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

. VS.

ROBERT LEE MERRITT, et ux., et al.

ORDER ALLOWING CERTIORARI-October 26, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. The case is consolidated with No. 134 and a total of one and one-half hours is allotted for oral argument of both cases.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

SUPREME COURT, U. B.

Office Supreme Court, U.S.

JUN 1 1964

JOHN F. DAVIS CLERK

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1963

No. 134

PARAGON JEWEL COAL COMPANY, Inc., Petitioner,

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No.

PARAGON JEWEL COAL COMPANY, INC., Petitioner,

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PARAGON JEWEL COAL COMPANY, INC., your petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in the above-entitled case on March 17, 1964.

OPINIONS BELOW

The opinion of the Tax Court (CIR Pet. App. 28-72)¹ is reported at 39 T.C. 257. The opinion of the court below (Appendix A, infra, pp. A1-A5) is reported at 330 F. 2d 161.

JURISDICTION

The judgment of the court below (Appendix C, infra, p. A6) was entered on March 17, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

- 1. Whether the decision below nullifies this Court's ruling in Parsons v. Smith, 359 U.S. 215, which held that the depletion deduction is available only to the owner of a capital interest in mineral in place.
- 2. The Tax Court found as facts that certain taxpayers, mining coal under contract with petitioner, lessee of the coal, (1) had no obligations under petitioner's coal leases and paid no royalties or taxes on the property or the mineral interest; (2) acquired no legal title either to the coal in place or to the coal after it was mined; (3) sold none of the coal to anyone other than to the lessee and were not entitled to do so; (4) were not concerned with the sale price the lessee received for the coal; (5) mined only as directed by the lessee; and, on conflicting evidence, (6) had no right to mine any specific area to exhaustion.

The Commissioner of Internal Revenue filed two briefs and appendices below, one as respondent in the consolidated case of the Merritts et als., and one as petitioner in the present case to review the decision of the Tax Court favorable to Paragon Jewel. The latter appendix, hereinafter cited as "CIR Pet. App.," contains the opinion of the Tax Court. We have filed nine extra copies thereof with our petition. Accordingly, pursuant to the second paragraph of Rule 23(1)(i), we are not reprinting the Tax Court's opinion as an appendix of our own.

There was no evidence that lessee ever executed any sublease of the mineral interest to its contractors.

The question presented is whether, having regard to the rule of Parsons v. Smith, 359 U.S. 215, where this Court declared that the depletion deduction was available only to the owner of a capital interest in mineral in place, the court below erred in holding that, on the foregoing facts, all of which were inconsistent with any ownership of or capital investment in the coal in place on the part of the contractors, they were none the less entitled to depletion on the floting that they shared an economic interest in the coal with the lessee, petitioner here.

3. Section 611(b)(1), I.R.C. 1954, continuing a provision in force since 1918, provides that, in the case of a lease, the deduction for depletion "shall be equitably apportioned between the lessor and lessee." Section 631(c), I.R.C. 1954, denies the lessor of coal any deduction for depletion, and defines "owner" for the purpose of computing the depletion allowance as any person who owns' an economic interest in coal in place, including a sublessor. Section 614(a), I.R.C. 1954, defines "property" for the purpose of computing the depletion allowance in the case of mines as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land." Section 631(b), I.R.C. 1954, defines an "owner" for the purpose of computing the depletion allowance as any person who owns an interest in timber, including a sublessor and a holder of a contract to cut timber.

The question presented is whether, in view of those provisions, there is any warrant in law for the holding below that a lessee of coal must share its depletion allowance with those with whom it has contracted to mine the coal and who plainly were not sublessees.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix C, infra, pp. A7-A10.

STATEMENT

The following facts were found by the Tax Court:

A. Paragon's leases and its mining contractors

Petitioner, Paragon Jewel Coal Company, Inc. (hereafter "Paragon"), acquired by assignment written leases on the coal in and underlying land in Buchanan County, Virginia. The leases required the lessee to mine either all or 85 per cent. of the minable coal in and underlying the leased tracts. Paragon assumed all the obligations of the lessees under the leases, and was obligated to pay annual minimum royalties, tonnage royalties, and land taxes. (CIR Pet. App. 55.) The individuals specified below, who mined the coal under contracts with Paragon, did not assume any of Paragon's obligations under its leases and paid no royalties or taxes on the property or the mineral interest (CIR Pet. App. 58). The contractors "acquired no legal title either to the coal in place or to the coal after it was mined" (CIR Pet. App. 62).

After acquiring the leases, Paragon made substantial investments necessary for mining, processing and marketing the coal, including the construction and maintenance of a tipple, processing equipment, a power line, a railroad sidetrack with four spurs running under the tipple, and a road from the tipple around the mountain close to the outcrop line of the coal over which coal could be trucked from the mines to the tipple. Paragon did not mine the coal itself, but contracted out the mining to various individuals and firms who were to mine the coal at their own expense and deliver, the coal to Paragon's tipple. Paragon would then clean and size the coal and sell it on the market... (CIR Pet/App. 55-56.)

Among Paragon's independent contractors were Standard Smokeless Coal Company, whose partners during the period here in question were Robert Lee Merritt, G. Wesley Merritt, James O. Watson, and Jack D. Merritt (CIR Pet. App. 56); Kyva Mining Company, a firm composed from time to time of G. Wesley Merritt, Jack D. Merritt, Watson, and Virgil Bowling (CIR Pet. App. 56); Farwest Coal Company, whose partners were Bowling and the three Merritts (CIR Pet. App. 57), and certain other firms and individuals (CIR Pet. App. 56-57).

The three Merritts, Watson, and Bowling, were petitioners in the consolidated proceeding in the Tax Court (CIR Pet. App. 28, 29), and were similarly petitioners in the consolidated proceeding below.

B. Paragon's mining contracts

The contracts between Paragon and the several contractors above named were oral, and were performed as follows:

As Paragon extended its road around the side of the mountain, the prospective contractor would be taken to various proposed sites for mine-openings, which Paragon would usually face up. After the contractor selected a particular site, Paragon's representative would nick out the general area in which the contractor could mine. The contractor agreed to mine the coal in that area and to deliver it to Paragon's tipple at his own expense. contractor was required to provide his own men and equipment, and, if necessary, to extend a road from Paragon's road to the mine portal. All expenses of opening and operating the mine were borne by the contractor. (CIR Pet. App. 58.) The contractor agreed either to provide his own power or to purchase it from Paragon, and also agreed to pay Paragon for engineering services inside the mine rendered by Paragon's engineer (CIR Pet. App. 59).

Paragon's engineer provided the contractor with a mine map showing the general direction in which the mine should progress, and showing where barriers between adjacent mines should be left so that one contractor didnot break through into the mine of the adjacent contractor. The engineer extended the projections from time to time. Paragon insisted on all contractors using the same engineer, who could project a system for mining all the coal under its leases without leaving unrecovered pockets of coal and to prevent one contractor from breaking into the mine of another contractor. The contractors were required to obtain Paragon's permission before pulling pillars as they retreated from an area which had been mined. (CIR Pet. App. 59-60.)

The contractors were not obligated to mine any specific amount of coal and were not specifically given the right to mine any particular area to exhaustion. The projections of the mines were based somewhat on the speed with which the contractor worked. If one contractor mined more rapidly, or if an adjacent mine cased operating, he might be given the right to pierce the indicated barrier. (CIR Pet. App. 61.)

C. Were the contracts terminable?

The Tax Court found (CIR Pet. App. 60) that "The contracts were not made for any specific period of time and nothing was said about the right to terminate by either party at the time the agreements were entered into."

The record contains two exhibits (CIR Pet. App. 75-90), both of which were sworn statements submitted by G. Wesley Merritt to the District Director of Internal Revenue at Richmond, Va., one on behalf of the Kyva Mining Company, the other on behalf of Standard Smokeless Coal Company, the affiant plus his partners in the two firms comprising all of the individual petitioners in the Tax Court and in the court below. In both of these

statements, which were sworn to and filed long before the present proceedings were commenced in the Tax Court, it was stated (CIR Pet. App. 79, 87) that "The partnership's contract with Paragon embraced the following understanding between the partners and Paragon," listing nine lettered items, of which the last (CIR Pet. App. 80, 87) was:

"(i) The contract specified the right of termination by either party at any time, but the question never arose between the partnership and Paragon."

To continue with the Tax Court's findings:

Numerous contractors ceased mining from time to time as they were unable to mine coal profitably or for other reasons. Such contractors were not permitted to remove buildings from the premises but usually took their equipment with them unless it was under lien to Paragon. It was anticipated by both parties that a contractor would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications. (CIR Pet. App. 60-61.)

D. Other provisions of the contracts

Paragon agreed to pay the contractor a fixed price per ton for coal delivered to its tipple, less 2½ per cent for rejects. It was understood that the price might vary from time to time. The price paid to Paragon to the contractors did vary, depending somewhat on the general trend of market prices for the coal over extended periods and to some lesser extent on labor costs. But price changes made by Paragon to the contractors were always prospec-

² The italics shown at CIR Pet. App. 80, 87, were not in the original documents; pencilled underscoring appears to have been added later.

tive and the contractors were notified several days in advance of any price change so that they always knew the price they would get for coal when they delivered it to the tipple. The contractor had no further control over the coal after it was delivered to Paragon, and did not know how or for what price Paragon sold or otherwise disposed of the coal. (CIR Pet. App. 58-59.)

During the years here involved, Paragon took all merchantable coal produced by the various contractors operating on Paragon's leased property and paid the contractors the price fixed by Paragon. Paragon sold very little of its coal under contract and the prices it obtained for coal varied quite frequently. If Paragon was unable to take all of the contractors' coal either because of lack of coal cars or because its tipple was full, the contractor would fill his own bins and then shut down until Paragon could take more coal. (CIR Pet. App. 61.)

The contractors completed their obligations under the contracts by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay them so much per ton. The contractors were not concerned with the sales price Paragon received for the coal. (CIR Pet. App. 61.)

The contractors paid nothing for the privilege of mining coal other than their investment in equipment, roads, and buildings and their cost in opening the mine and mining the coal. They acquired no legal title either to the coal in place or to the coal after it was mined. The coal as delivered to Paragon's tipple by the contractors was not in a state which was salable to the consumer but had to be washed, graded, and treated in order to be salable on the consumer market. All such processing was done by Paragon at its processing plant. The contractors sold none of the coal to anyone other than Paragon, and were not entitled to do so. (CIR Pet. App. 62.)

E. The depletion issue in the Tax Court

Paragon claimed percentage depletion on its income tax returns for the taxable years ending September 30, 1955, 1956, and 1957. Standard Smokeless and Kyva claimed percentage depletion on their partnership returns for the calendar years 1954, 1955, and 1956. The Commissioner disallowed both sets of deductions, whereupon Paragon and the several partners in Standard Smokeless and Kyva separately filed petitions in the Tax Court contesting the resultant deficiencies. All the petitions were consolidated for hearing. (CIR Pet. App. 29, 62-63.)

The Commissioner took no position in the Tax Court on the depletion issue, the only one now remaining, beyond agreeing that either Paragon or the contractors were entitled to the depletion deduction, but not both (CIR Pet. App. 63).

The Tax Court held (CIR Pet. App. 63-72) that, under the rule of Parsons v. Smith, 359 U.S. 215, Paragon alone was entitled to the depletion deduction. After making the findings outlined above, the Tax Court said in its opinion (CIR Pet. App. 70-71), "While we cannot find that the right to terminate was specifically mentioned when the agreements were made, neither can we conclude that the agreements were nonterminable.

"On the facts in this case we conclude that the contractors could look only to the difference in their cost of mining the coal and the amount Paragon paid them for a return of their investment, that they made no investment in and acquired no economic interest in the coal in place, and that consequently they are not entitled to depletion on the coal they produced." Decision was entered accordingly (CIR Pet. App. 73-74).

F. Proceedings in and holding of the court below

The contractors—the Merritts et als.—petitioned for review in the court below, but at that stage the Commissioner abandoned neutrality, and supported Paragon's sole right to the depletion allowance. The Commissioner's points were these (CIR Resp. Br. 4-19):

"The Tax Court correctly held that the Merritt group is not entitled to percentage depletion on the payments they received from Paragon for extracting coal.

- "A. Whether the Merritt group acquired economic interests in the coal in place, so as to be entitled to depletion allowances, depends upon whether they made investments in the coal in place which were necessarily reduced as the coal was extracted.
- "B. Under the Tax Court's findings, the Merritt group made no investments in the coal in place which were necessarily reduced as the coal was extracted; their investments were not in any specified area or fraction of the coal in place, for they were not given the right to mine any particular area to exhaustion and were not obligated to mine any or all of the coal to exhaustion.
- "C. The Tax Court's findings are not clearly erroneous and therefore dispose of the case."

However, in order to protect the revenue and solely for that reason, the Commissioner filed a cross-petition to review the decision in favor of Paragon. He said in support of that cross-petition (CIR Pet. Br. 13-14):

"Although the position of the Commissioner is essentially that of a stakeholder, it is our view that the Tax Court correctly decided this case. Since the Commissioner's petition from the adverse decision vis-avis Paragon is essentially a protective one, in the argument below we will only outline briefly our reasons for believing the decision below is correct."

Nonetheless, the court below reversed (Appendix A, infra, pp. A1-A6). After all but rewriting the terms of the oral agreement as those had been found by the Tax Court (pp. A4-A5), it concluded (p. A5) that "the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of those contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith, 359 U.S. 215

REASONS FOR GRANTING THE WRIT

The decision below requires review because it is the culmination of a series of rulings by the Fourth Circuit that first whittled away and now completely sets aside a recent decision here, Parsons v. Smith, 359 U.S. 215, where this Court disapproved the rationale of earlier Fourth Circuit decisions on the precise issue. Now the court below has reverted to previous doctrines, reviving in the process a fiction the his Court five years ago advisedly refused to indulge.

reaffirmed the proposition that "the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset." There, as here, the mining contracts (p. 224) "do not show or suggest that [the contractors] actually made any capital investment in the coal in place, or that the landowners were to or actually did in any way surrender to [the contractors] any part of their capital interest in the coal in place. [The contractors] do not factually assert otherwise. Their claim to the contrary is based wholly upon an asserted legal fiction. As stated, they claim that their contractual right to mine coal from the designated lands and the use of their equipment,

organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place." Accordingly, this Court denied the contractors in *Parsons* any deduction for depletion.

Accord, United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 86: "Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator."

The foregoing rationale necessarily disapproved the Fourth Circuit's earlier reasoning, both as to the purpose of the deduction and as to the nature of the requisite investment, as that reasoning appeared in a number of its decisions antedating Parsons. In those earlier decisions the court below had held that an "economic interest in the operation," based not on investment in the coal in place but upon investment in machinery and equipment, entitled the coal contractors to depletion in coal it never owned, on the footing that "they were entitled to shape in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset." Commissioner v. Gregory Run Coal Co., 212 F. 2d 52, 55, 61, certiorari denied, 348 U.S. 828; Weirton Ice & Coal Supp. Co. v. Commissioner, 231 F. 2d 531, 535; Commissioner v. Hamill Coal Corp., 239 F. 2d 347, 350-351; Stillwell v. United States, 250 F. 2d 736.

2. The rationale of Parsons was followed by the Third Circuit in Denise Coal Company v. Commissioner, 271 F. 2d 930, and by the Tax Court in a whole series of cases, including the present one. Utah Alloy Ores, Inc., 33 T.C. 917; Walter Bernard McCall, 37 T.C. 674; J. Shelton Bolling, 37 T.C. 754; William M. Legg, 39 T.C. 30; Raymond E. Cooper, 39 T.C. 253; Robert Lee Merritt, 39 T.C. 257 (the present case); Elm Development Co., 21 TCM 239; Raymond C. Desrosiers, 21 TCM 264; Cecil C. Lawson, TCM 1963-179 (CCH Dec. 26,203(M); P-H \$63,179); W.

P. Isom, TCM 1963-308 (CCH Dec. 26,403(M); P-H ¶63,308).

But the Fourth Circuit has—with a single exception, now quite without vitality—significantly failed to follow Parsons as written.

- (i) In United States v. Stallard, 273 F. 2d 847, although denying depletion to taxpayers who mined coal under contract, it reduced the seven factors set out in Parsons, 359 U.S. at 225, to the single factor of terminability.
- (ii) In Elm Development Company v. Commissioner, 315 F. 2d 488, the contract plainly negatived any ownership of the coal by the contractor at any time. The Commissioner accordingly argued (Br. 9-35) that "The Tax Court correctly concluded that Elm Development Company had no investment interest in the coal in place on Lorado's leasehold." But the Fourth Circuit allowed depletion to the contractor none the less, on the ground that the contract was terminable only for its default or lack of profitability to the lessee, concluding (315 F. 2d at 491) that when the contract is not terminable at will or on short notice, "the mining company has been granted a right in the coal in place; that is, the right to mine till exhaustion."
- (iii) in Cooper v. Commissioner, 330 F. 2d 163, decided simultaneously with and on the authority of the present case, where the Tax Court had found as a fact on con-

³ We quote the following from R. 9a in that case, as set forth at pp. 13-14 of the Commissioner's brief there:

[&]quot;Title to all coal mined and delivered by the Contractor shall at all times, from the time of its severance until its sale by the Company, remain in the Company and Contractor shall have no interest in the coal or in any proceeds from the sale thereof.

[&]quot;All obligations of the Company to make payments to Contractor hereunder shall be obligations owed by the Company to be paid out of its funds or assets and Contractor shall have no lien or charge against any of the coal produced by it or against the proceeds from the sale thereof."

flicting evidence that the contracts were subject to termination by the lessee (39 T.C. at 256), the Fourth Circuit none the less reversed and held the contractors entitled to depletion.

(iv) In the present case, in the teeth of findings by the Tax Court that clearly negatived any conveyance to the contractors, or any ownership by them of the coal either in place or after extraction, the Fourth Circuit, brushing aside a finding that there was no right to mine to exhaustion (CIR Pet. App. 61), found (infra, p. A5) "the intent of the parties to vest in the operators a right to mine to exhaustion" none the less. Further, emphasizing (infra, p. A4) that "The parties contemplated that the operators would, and the evidence shows that they did, engage in large expenditures of time and money in preparing their respective sites for mining," the court concluded that (infra, p. A5) "By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith, 359

Otherwise stated, the court below, while paying the lip service of citation to this Court's decision, has revived the fiction there laid, has ignored its rationale that the deduction for depletion inures only to those who have ownership of and capital investment in the mineral in place, and has in consequence effectively nullified its holding.

In Stilwell v. United States, 250 F. 2d 736, 739, a pre-Parsons case involving another of petitioner's contractors, the Fourth Circuit proceeded on the basis that the contract was not terminable—disregarding utterly a specific finding of fact by the district court that "The contract entered into between plaintiffs and Paragon was terminable at the will of either party" (Fdg. 14, 152 F. Supp. 111, 113).

⁵ In McCall v. Commissioner, 312 F. 2d 699, the court below came closest to full acceptance of the ownership concept of Parsons. But the opinion there, written by a district judge, has not been followed since, as the text above clearly demonstrates.

Second. This case does not turn on facts, nor does it involve a congeries of disparate facts. The findings of the Tax Court establish the presence of six out of the seven factors relied on in Parsons, 359 U.S. at 225, and the sworn ante motam litem statements of G. Wesley Parsons on behalf of all the taxpayer contractors (CIR Pet. App. 80, 87, quoted supra, p. 7) sufficiently establish the seventh Parsons factor, terminability. Inasmuch as the leases here (CIR Pet. App. 55) "required the lessee [Paragon, petitioner here] to mine either all or 85 percent of the minable coal in and underlying the tracts under lease," there was, as a matter both of State and general law (13 Michie's Jurisprudence of Virginia and West Virginia 25-26 [Mines and Minerals, §14, and cases there cited]), an actual sale to petitioner of the coal in place. Very plainly, therefore the contractors had no property in that coal. For, as the Tax Court found, the contractors here did not assume any of petitioner's obligation under those leases (CIR Pet. App. 58), they paid no taxes on the property (ibid.) as owners of a mineral interest were required by State law to do (Va. Code, §58-774, infra, p. A10), and they acquired no legal title to the coal in place (CIR Pet. App. 62), as petitioner did here. In short, see Parsons at p. 225, item 4, "the landowners did not agree to surrender and did not actually surrender to [the contractors] any capital interest in the coal in place."6

others dealing with coal depletion involve that fractionalization of interests that is so characteristic in the oil and gas situation. E.g., Palmer v. Bender, 287 U.S. 551; Helvering v. Bankline Oil Co., 303 U.S. 362; Anderson v. Helvering, 310 U.S. 404; Kirby Petroleum Co. v. Commissioner, 326 U.S. 599; Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25.

Accordingly, we have not particularized the holdings in recent oil and gas depletion cases involving problems similar to the one now considered. Scofield v. LaGloria Oil and Gas Co., 268 F. 2d 699 (C.A. 5), certiorari denied, 361 U.S. 933; CBN Corporation v. United States, 328 F. 2d 316 (C.Cls.); United States v. Thomas, 329 F. 2d 119 (C.A. 9).

Moreover, quite apart from the two factual issues here that were contested below, the totality of the undisputed and indisputable facts establishes conclusively that these contractors did not own a single lump of coal when their work commenced, and did not own a single lump when they finished. They are therefore not entitled to depletion, for the obvious reason that no part of their property and no part of their capital investment in coal in place was ever depleted by their mining operations.

Property, and property alone, is the touchstone entitling to depletion; that has been true, from United States v. Ludey, 274 U.S. 295, 302, through Thomas v. Perkins, 301 U.S. 655, 663 ("Ownership was essential"), Helvering v. Bankline Oil Co., 303 U.S. 362, 366-369, and Rarsons v. Smith, 359 U.S. 215, 220, down to \$614(a), I.R.C. 1954 (infra, p. A8), and \$1.611-1(b) (1) of the current regulations (infra, p. A10).

Here the undisputed facts negative any property interest whatever in the coal on the part of the contractors, and likewise negative any investment by them in the coal in place. We are confirmed in this view by the circumstance that the Commissioner in this case, though technically a stakeholder, argued vigorously on our side below (supra, p. 10), as indeed he had similarly argued on the side of the lessee in the Elm Development case (supra, p. 13). All of the other facts and factors discussed in the decisions are significant only as indicia of property and capital investment in mineral in place.

Accordingly, the basic question here is whether the doctrine of *Parsons* v. *Smith* will be enforced—or whether the Fourth Circuit will be permitted to reapply its pre-

^{7 (1)} Terminability—where the Tax Court failed to find a fact sworn to on behalf of all the parties adverse to petitioner long before the litigation started; (2) the asserted right to mine to exhaustion—where the court below set aside a finding made by the Tax Court on conflicting evidence.

Passons view (Commissioner v. Gregory Run Coal Co., 212 F. 2d 52, 55, 61, supra) that (a) it is sufficient for the contractor to have "an economic interest in the operation," rather than in the coal in place as required by Parsons; and to reapply its other pre-Parsons view that (b) the statute was "designed to give compensation to persons interested in the production of a wasting asset," rather than, as held in Parsons, that its purpose was "to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset," and as held in Cannelton Sewer Pipe, that it was "an allowance for the exhaustion of capital assets."

As matters now stand, Parsons v. Smith is not law in the Fourth Circuit, where the great majority of the mining contract cases have arisen—and will in future arise if the present decision goes unreviewed.

Third. In reverting to its earlier views on coal depletion in the present case, the Fourth Circuit further overlooked the circumstance, duly pressed upon it in argument and brief, that under existing statute law, in force during the taxable years here in question, there was no warrant for allowing any percentage depletion to one who merely had a contract to mine coal—and of course the deduction for depletion, like all other deductions, is a matter of legislative grace. Parsons v. Smith, 359 U.S. at 219 and cases cited in note 5.

1. Section 611(b)(1), I.R.C. 1954 (infra, p. A7), carrying forward a provision in force since 1918, provides that, in the case of a lease, the deduction for depletion "shall be equitably apportioned between the lessor and lessee."

But §631(c) (infra, p. A9), which grants a coal lessor capital gains treatment for his royalties, goes on to pro-

^{*}Rev. Act of 1918 and 1921, §214(a)(10); Rev. Acts of 1924 and 1926, § 214(a)(9); Rev. Acts of 1928 and 1932, § 23(1); Rev. Acts of 1934, 1936, and 1938, §23(m); I.R.C. 1939, §23(m).

vide that "Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal."

That is to say, there is no longer any statutory basis for apportionment of the depletion allowance with respect to coal leases: the lessee, petitioner here, is entitled to the entire allowance. And here, of course, it cannot possibly be contended that petitioner's arrangements with its contractors were leases in any sense.

- 2. The contractors' lack of entitlement to any deduction for depletion is further emphasized by two other statutory provisions.
- (a) The timber depletion subsection, §631(b) (infra, p. A8 at A9) defines "owner" for the purpose of computing the depletion allowance as "any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber." But the coal depletion subsection, §631(c) (infra, p. A9), defines the same word for the same purpose as "any person who owns an economic interest in coal in place, including a sublessor."

That is to say, Congress well knew the distinction between the owner of an economic interest and the holder of a contract to cut. If it had intended to extend benefits to the holder of a contract to mine coal, it could easily have said so.

(b) Section 614(a), infra, p. A8, defines property for the purpose of computing the depletion allowance in the case of mines, as "each separate interest owned by the taxpayer in each mineral deposit in each separate trace or parcel of land."

Here, very plainly, since none of the contractors owned any interest whatever in the mineral deposits in question, they did not qualify under the statute. The "economic interest" granted them by the court below not only can-

not rise above the level of a semanticized fiction, it is denied them on a plain reading of the statute law.

Fourth. The decision below if permitted to stand will have serious litigation-breeding consequences. As the Commissioner said in the Elm Development case, 315 F. 2d 488, supra, "The continued substantial volume of depletion litigation undertaken by coal contractors subsequent to the Supreme Court's decision in Parsons v. Smith, 359 U.S. 215, is nothing less than 'a tribute to the tenacity of the American taxpayer'" (CIR Br., p. 9).

Now, with Parsons v. Smith disregarded in the Fourth Circuit—where most of the coal contractor cases arise that volume of depletion litigation will assuredly increase, and at all levels: Every individual mining coal under contract in the hills of Virginia and West Virginia, encouraged by the recent decisions, will claim a deduction for depletion, regardless of the terms of his contract: refund claims in large numbers will assuredly be filed by taxpayers who had, up to now, assumed that Parsons foreclosed them: where contractors have succeeded in obtaining deductions from the court below in disregard of the Parsons principles, fee owners and coal lessees whose returns are still open may be expected to pay under protest and sue in the Court of Claims, where their contractors' earlier success cannot bar them; and in the . Tax Court, which has faithfully followed and applied Parsons, see cases cited supraat pp. 12-13, only to be reversed at least three times by the

The provisions herein discussed giving coal lessors capital gains treatment of royalties were not enacted until after the taxable years considered in Parsons v. Smith. See Section 325(b) of the Revenue Act of 1951, amending §117(k)(2), I.R.C. 1939. In 1954, sublessors of coal were included as beneficiaries, to obviate the decision in Island Creek Coal Co., 30 T.C. 370, while § 614(a), I.R.C. 1954 (infra, p. A8), which defines "property" for purposes of depletion, restated in legislative form what had previously rested only on regulation. Treas. Reg. 111, § 29.23(m)-1(i).

court below in consequence, 10 near chaos may be anticipated. For and this is the nub of the matter—the principles that all concerned believed to have been settled by. Parsons v. Smith are nullities in the circuit in which the bulk of the country's contract coal mining takes place.

CONCLUSION

This Court's writ in coal depletion cases does not now run in the Fourth Circuit. The present petition for certiorari should therefore be granted.

Respectfully submitted.

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JUNE 1964.

¹⁰ Elm Development Co., 21 TCM 239, reversed, 315 F. 2d 488; Raymond E. Cooper, 39 T.C. 253, reversed, 330 F. 2d 163; Robert Lee Merritt, 39 T.C. 257, reversed, 330 F. 2d 161 (infra, pp. A1-A5).

APPENDIX A

Opinion Below

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 9179.

Robert Lee Merritt and Winnie Merritt; G. Wesley Merritt and Fannie J. Merritt; Jack D. Merritt and Willa Gray Merritt; Virginia Bowling and Gladys Bowling, and James O. Watson, 3rd, and Lucy J. Watson, Petitioners,

versus

Commissioner of Internal Revenue, Respondent,

and

Commissioner of Internal Revenue, Petitioner,

versus

Paragon Jewel Coal Company, Inc., Respondent.

ON PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES.

(Argued January 13, 1964. Decided March 17, 1964.)

Before HAYNSWORTH, BRYAN and J. SPENCER BELL, Circuit Judges. John Y. Merrell for Petitioners, Taxpayers; Michael Mulroney, Attorney, Department of Justice, (Louis F. Oberdorfer, Assistant Attorney General, and Lee A. Jackson and Melva M. Graney, Attorneys, Department of Justice, on brief) for Commissioner of Internal Revenue, and Frederick Bernays Wiener (Leroy Katz and Carl C. Gillespie on brief) for Respondent, Paragon Jewel Coal Co., Inc.

J. SPENCER BELL, Circuit Judge:

These are consolidated appeals from the Tax Court. The issue is whether the lessee, Paragon Jewell Coal Company, Inc. [hereinafter referred to as Paragon], is entitled to the entire depletion deduction on the coal mined from its leased property or whether the several contract mine operators, petitioners in this action [hereinafter referred to as the operators], are entitled to a part of that depletion deduction based upon the amounts received by them respectively for the coal which each of them mined under agreements with Paragon. The Tax Court, which heard the cases together, decided that the lessee, Paragon, was entitled to the entire percentage depletion deduction. operators appeal, contending that Paragon is required to share the deduction with them. The Commissioner, who took a neutral position as between the petitioners and Paragon before the Tax Court, appeals the decision in Paragon's case in order to protect his position as a stakeholder, conceding that either the operators or the lessee is entitled to the deduction, but not both.

Since the Commissioner concedes that either the operators or the lessee, Paragon, is entitled to the deduction, we find it unnecessary to go into all of the factual background, but shall confine ourselves to that part which we consider relevant to a decision of the issue between the parties. Paragon is the assignee of certain leases of coal bearing

lands under which it has paid minimum royalties, tonnage royalties and land taxes. It has made substantial investments on the properties in order to prepare itself to process, ship and market the coal which was produced. Paragon's experience was as a processor and seller of coal rather than a producer; furthermore it lacked the capital to go into the producing end of the business. Rather than mine the coal itself, it entered into oral agreements with the petitioning operators and others to mine the coal by a method known as drift mining. In addition to the equipment necessary for storing and processing the coal, Paragon installed a goad running around the monutain close to the outcrop line of the coal over which the coal could be trucked from the mines to Paragon's tipple, where Paragon cleaned, sized and sold the coal.

Beginning with the Stilwells in 1951 (who are not petitioners here), Paragon entered into oral leases with a number of operators, all of which were similar in terms, Under the agreement an operator would be allocated a specific surface area under which it might mine. The allocation was made either by pointing it out on the ground or by showing it to him on the over-all property map. The operator agreed to mine the coal within that area and deliver it to Paragon at the operator's own expense. All expenses of opening and operating the mines were borne by the several operators. Paragon agreed to pay a fixed price at the tipple, but it was understood that the price would, and in fact it did, vary with the market. operators were required to use and pay for the services of Paragon's engineer and to operate and maintain their mines in accordance with state and federal regulations. The contracts were silent as to who was entitled to deple-

¹ Drift mining is done by driving a hozizontal shaft into the hillside in order to extract the coal from seams which are usually less than three feet in thickness. The process is a difficult and economically marginal operation.

tion. They contained no termination date and nothing was said between the parties on this subject. The Tax Court found that:

It was anticipated by both parties that a contractor [contract mine operator] would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications.

Because the contracts did not contain a specific statement that they were not terminable at the will of Paragon and because they did not contain a specific statement that the operator had a right or obligation to mine to exhaustion, the Tax Court concluded that as a matter of law the operators did not under the contracts have such rights.

We must disagree with the Tax Court's conclusions of law. Its own findings as to the intent of the parties quoted above negates its conclusions as to the legal rights of the parties under the contract. The parties contemplated that the operators would; and the evidence shows that they did, engage in large expenditures of time and money in preparing their respective sites for mining. We think the Tax Court was in error in concluding that because the oral contracts were silent on the point, the operators did not possess a non-terminable right to mine to exhaustion, especially in the face of the court's finding of an intent on the part of the parties to the contrary. It would be inequitable indeed to hold that Paragon might remain silent on this point until the operators had invested their time and money and then take the benefit of the operators' efforts at will and without cause. The burden was on Paragon to express the limitation, if any. Jack's Cookie Co. v. Brooks, 227 F.2d 935 (4 Cir. 1955), cert. denied, 351 U.S. 908 (1956). Paragon was under obligation to mine the property. These operators were performing Paragon's obligation under its leases and this constituted ample consideration running from the operators to Paragon to make their mutual intentions with respect to the contract binding on Paragon. The fact that the contracts did not fix upon the operators an obligation to mine to exhaustion does not vitiate the binding effect of the intent of the parties to vest in the operators a right to mine to exhaustion. That the operators could cease mining would not destroy the mutuality. Phillips Petroleum Co. v. Buster, 241 F.2d 178 (10 Cir.), cert. denied, 355 U.S. 816 (1957).

Thus we see under this interpretation of the contracts, the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith, 359 U.S. 215 (1959); Elm Dev. Co. v. Commissioner, 315 F.2d 488 (4 Cir. 1963); and Stilwell v. United States, 250 F.2d 736 (4 Cir. 1957). The Tax Court's decisions are reversed and the cases remanded for entry of an order in conformity with this opinion.

Reversed and Remanded.

² Indeed the Stilwell case arose out of the same facts, although of course the record being different, it is not res judicata.

APPENDIX B

Judgment Below

Filed and Entered, March 17, 1964 [Caption omitted]

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by

counsel.

On consideration whereor, It is now here ordered and adjudged by this Court that the decisions of the said Tax Court of the United States, in this cause, be, and the same are hereby, reversed; and that this cause be, and the same is hereby; remanded to the Tax Court of the United States for the entry of an order in conformity with the opinion of the Court filed herein.

- /s/ CLEMENT F. HAYNSWORTH, JR. United States Circuit Judge.
- /S/ ALBERT V. BRYAN United States Circuit Judge.
- /s/ J. SPENCER BELL United States Circuit Judge.

APPENDIX C

Statutes and Regulations Involved

1. Sections 611 (a) and (b), I.R.C. 1954, as amended, are as follows:

Sec. 611. Allowance of deduction for depletion

"(a) General rule.—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletition and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613 (c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

"(b) Special rules .-

- "(1) Leases.—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.
- "(2) Life tenant and remainderman.—In the case of property held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.
- property held in trust.—In the case of property held in trust, the deduction under this section shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the

trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

- "(4) Property held by estate.—In the case of an estate, the deduction under this section shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each."
- 2. Section 613(a), I.R.C. 1954, is as follows:

"§ 613. Percentage depletion

- "(a) General rule.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section."
- 3. Section 614(a), I.R.C. 1954, is as follows:

"§ 614. Definition of property

- "(a) General rule.—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."
- 4. Sections 631(b) and (c), I.R.C. 1954, are as follows:
 - "(b) Disposal of timber with a retained economic interest.—In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such

timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.

"(c) Disposal of coal with a retained economic interest. In the case of the disposal of coal (including lignite), held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal, and the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. subsection shall have no application, for purposes of applying sub-chapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b) (6) or section 545(b) (5))."

5. The third paragraph of Section 58-774 of the Code of Virginia provides as follows:

"If the surface of the land is held by one person and the coal, iron and other minerals, mineral waters, gas or oil under the surface be held by another person, the estate of each and the relative fair market value of their respective interests shall be ascertained by the commissioner [of revenue of the respective county]."

6. Section 1.611-1(b)(1) of the Regulations under I.R.C. 1954 is as follows:

"NATURAL RESOURCES

"§ 1.611-1 Allowance of deduction for depletion

"(b) Economic interest. (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must clook for a return of his But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possess a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed e to the corporation and not to its shareholders."

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. -

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

ROBERT LEE MERRITT AND WINNIE MERRITT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

G. WESLEY MERRITT AND FANNIE J. MERRITT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

JACK D. MERRITT AND WILLA GRAY MERRITT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VIRGIL BOWLING AND GLADYS BOWLING

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

JAMES O. WATSON 3D AND LUCY J. WATSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of

certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in the aboveentitled cases.

OPINIONS BELOW

The opinion of the Tax Court is reported at 39 T.C. 257. The opinion of the court of appeals is reported at 330 F. 2d 161.*

O JURISDICTION

The judgment of the court of appeals was entered on March 17, 1964. By order of the Chief Justice, the time for petitioning for a writ of certiorari was extended to and including July 15, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether respondents, who mined coal under oral contracts with a lessee of mineral rights from whom they received a specified price per ton, were entitled to percentage depletion allowances on the amounts received from the lessee.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 613. PERCENTAGE DEPLETION.

(a) General Rule.—In the case of the mines, wells, and other natural deposits listed in sub-

^{*}The opinion is printed at pp. A1-A4 of the petition for certiorari in Paragon Jewel Coal Company Inc. v. Commissioner, No. 134, this Term, upon the granting of which this petition is conditioned. We have accordingly not reprinted the opinion in this petition.

section (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). * * In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

STATEMENT

Paragon Jewel Coal Company holds mineral leases on coal-bearing lands in Virginia. It entered into oral contracts with respondents whereby respondents undertook to mine the coal and deliver it to Paragon's tipple in return for a per-ton price subject to change by Paragon. Paragon then sold the coal on the open. market. In tax returns for years 1954 to 1957 both Paragon and respondents sought to take percentage depletion allowances under Section 613 of the Internal Revenue Code of 1954 on the amounts paid by Paragon to respondents. Petitioner disallowed the deductions to both Paragon and respondents. Tax Court, in consolidated proceedings, held that the oral agreements between Paragon and respondents did not give respondents an "economic interest" in the coal in place so as to entitle them to depletion allowances under this Court's decision in Parsons v.

Smith, 359 U.S. 215. It sustained Paragon's claim to depletion allowances on these amounts. The court of appeals reversed and directed the entry of judgment sustaining respondents' claims and rejecting those of Paragon. Paragon has filed a petition for certiorari seeking review in this Court of the court of appeals' rejection of its claim for depletion allowances on the amounts it paid to respondents. Paragon Jewel Coal Company, Inc. v. Commissioner, No. 134, this Term.

BEASONS FOR GRANTING THE WRIT

The government is essentially a stakeholder in this dispute between Paragon and respondents over who, under their oral agreements, has the required "economic interest" in the coal-mining property in relation to the amounts paid to respondents, so as to be entitled to the percentage depletion allowance thereon granted by Section 613 of the Internal Revenue Code of 1954. It is clear that "two or more persons 'cannot be entitled to depletion on the same income." Parsons v. Smith, 359 U.S. 215, 220. Hence if Paragon's petition for a writ of certiorari were granted and the judgment of the court of appeals were reversed, the judgment would also have to be reversed insofar as it sustained respondents' claim to depletion allowances on the same income. The present petition is being filed in order to protect the government's interest should Paragon ultimately prevail.

Accordingly, this petition should be granted if the Court grants the petition in No. 134.

Respectfully submitted.

ARCHIBALD COX, Solicitor General. Louis F. OBERDORFER, Assistant Attorney General. MELVA M. GRANEY, MICHAEL MULRONEY, Attorneys.

JULY 1964.



In the Supreme Court of the United States.

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., PETITIONER v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner holds mineral leases on coal-bearing lands in Virginia. It entered into oral contracts with several individuals and partnerships for the removal of the coal. Under the terms of the contracts the individuals and partnerships were to mine coal and deliver it to petitioner's tipple in return for a perton price established from time to time by petitioner. Petitioner then sold the coal on the open market. As a lessee, petitioner was entitled to percentage depletion on its "gross income from the property." Section 613 of the Internal Revenue Code of 1954. The question here is whether petitioner was entitled to

include as "gross income from the property" the amount it received but paid to the contract miners for their services. This issue, in turn, depends on whether the miners acquired "economic interests" in the coal in place under their contracts with petitioner. If so, the amounts received by the miners constituted their own "gross income from the property" and were depletable by them, and not by petitioner. Parsons v. Smith, 359 U.S. 215.

The Commissioner denied depletion to both petitioner and the miners on the amounts paid to the miners, and both parties petitioned the Tax Court for review of the resulting deficiencies. In the Tax Court proceedings, the government conceded that either petitioner or the contract miners, but not both, could take . depletion deductions on the amounts paid to the miners. After hearing conflicting evidence on the contract terms, the Tax Court held that the oral agreements between the parties did not give the contract miners an "economic interest" in the coal in place so as to entitle them to depletion, and allowed depletion deductions to petitioner only. In the court of appeals, the government supported the Tax Court's decision. The court of appeals reversed the Tax Court and directed the entry of judgment against petitioner and in favor of the contract miners.

Parsons v. Smith, supra, presented the same issue on substantially similar facts. In the present case, the Tax Court found that the oral contracts created a relationship between the parties that was indistinguishable from those in Parsons. The Fourth Cir-

cuit distinguished Parsons on the ground that in this case the contract miners had a right to mine a specific area to exhaustion. In so doing, it followed the pattern of its earlier decision in Elm Development Co. v. Commissioner, 315 F. 2d 488, in which it also distinguished Parsons because of the absence of a contract right to terminate the relationship on short notice.

We believe that the decision of the court of appeals is basically in conflict with Parsons. However, we do not think that the issue is of sufficient importance at this time to require this Court to consider the present case. Other courts are likely to follow Parsons rather than the decision here, so that the present case will have precedential value only in the Fourth Circuit. Moreover, since Parsons demonstrated the wisdom of a written contract clearly defining the agreement of the parties, the issue presented in that case and in this one is likely to arise only in cases involving agreements made prior to Parsons or without the benefit of tax counsel.* Finally, with the decision in Parsons having been so recently announced, there seems little reason to believe that this Court's application of its principles to the particular facts of this case would add significantly to a clarification of the law in this difficult area. On balance, and despite the clear error of the decision below, we believe it appropriate for the Court to await further developments before undertaking another review of this question. It is sub-

^{*}Dotson v. United States, No. 23-62, pending in the Court of Claims, raises the same issue. The taxpayers there are contract miners under oral contracts.

mitted, accordingly, that the petition for certiorari should be denied.

Respectfully submitted.

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Assistant Attorney General.

Melva M. Graney,

Michael Mulroney,

Attorneys.

JULY 1964.

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IN THE

Supreme Court of the United States

OCTOBER THEM, 1964

No. 134

Panagon Jewel Coal Company, Inc., Petitioner,

COMMISSIONER OF INTERNAL REVENUE

On Patition for a Writ' of Certioreri to the United States Court of Appeals for the Fourth Circuit

PETITIONER'S REPLY NEMORANDUM

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964 .

No. 134

PARAGON JEWEL COAL COMPANY, Inc., Petitioner,

V.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITIONER'S REPLY MEMORANDUM

The terms of the Commissioner's opposition suggest that a few clarifying words in reply may be of assistance to the Court in its consideration of the present petition.

First. The Commissioner (Mem. Op. 3) speaks of "the clear error of the decision below", agrees (Mem. Op. 2) that Parsons v. Smith, 359 U.S. 215, "presented the same issue on substantially similar facts", and further agrees that (Mem. Op. 3) "the decision of the court of appeals is basically in conflict with Parsons."

Second. The Commissioner does not deny that the court below has reverted to its pre-Parsons position, a position wholly at variance, both in reasoning and result, with this Court's holding in Parsons (Pet. 11, 12-14, 16-17). Significantly enough, Parsons involved review and affirmance of two decisions by the Third Circuit (Parsons v. Smith,

255 F. 2d 595; Huse v. Smith, 255 F. 2d 599), in both of which certiorari was sought here on the footing of conflict with decisions of the Fourth Circuit. Consequently this case involves not only the Fourth Circuit's present refusal to follow Parsons as written, but, what is far more disturbing, an actual reversion to its own earlier doctrines that were necessarily disapproved by this Court's Parsons opinion.

Third. Our assertion (Pet. 19-20) that most of the cases involving claims for depletion allowances made by coal mining contractors have arisen and will continue to arise in the Fourth Circuit is not contradicted, nor could it be, a circumstance that quite undercuts the Commissioner's bland reassurance. (Mem. Op. 3) that "the present case will have precedential value only in the Fourth Circuit." For, even in situations that do not even remotely involve the disregard of this Court's decisions that is reflected here, it is ground for review that a particular industry is concentrated in a single circuit. E. g., Schriber-Schroth. Co. v. Cleveland Trust Co., 305. U.S. 47, 50. Nor is it adequate to suggest, either (Mem. Op. 3) that a subsequent conflict with another court may arise—there is presently a conflict with the Third Circuit's post-Parsons ruling in Denise Coal Company v. Commissioner, 271 F/2d 930, and, far more important, an admitted (Mem. Op. 3) conflict with this Court's decision in Parsons-or to urge (Mem. Op. 3) that lessees and landowners should protect themselves with written contracts. For, as has been demonstrated (Pet. 13), not even an unambiguous written contract prevented the court below from disregarding Parsons in its Elm Development decision, 315 F. 2d 488.

[&]quot;The decision of the Court of Appeals below is squarely in conflict with the decisions of the Court of Appeals for the Fourth Circuit" (Pet. 9, Parsons v. Smith, No. 218, Oct. T. 1958); "The decision of the Court of Appeals is in conflict with the decisions of the Court of Appeals for the Fourth Circuit" (Pet. 10, Parsons v. Huss, No. 305, Oct. T. 1958).

Fourth. The Commissioner's opposition to our petition comes to this, that since the law as to coal contractors' non-entitlement to depletion has been settled by this Court, and since it is everywhere applied—except only in the court below, where most of the cases involving that question arise (because that is where the bulk of coal mining under contract is done)—this Court should walk by on the other side while its own rulings are there disregarded.

We think that such an approach involves an inadmissible concept of judicial administration. Lower courts simply cannot be permitted to disregard this Court's rulings with impunity, least of all when such disregard involves a return to prior principles of their own that had earlied been disapproved here.

Nor should acquiescence by a public officer in (Mem. Op. 2) "the clear error of the decision below" dissuade this Court from instant corrective action now. Just at "no stipulation by the Government could circumscribe this Court's power to see that its mandate is carried out" (United States v. duPont & Co., 366 U.S. 316, 325, note 6), so the Commissioner's rather cavalier offer of a dispensation from the duty of the court below to comply with this Court's decisions must be rejected. After all, the circumstance that the decision of a court of appeals disregards a ruling here has been a ground for certiorari ever since the principles governing the grant of the writ were first formulated.

Fifth. The Commissioner suggests (Mem. Op. 3) that, "with the decision in Parsons having been so recently announced, there seems little reason to believe that this Court's application of its principles to the particular facts of this case would add significantly to a clarification of the law in this difficult area."

² Rule 35(5)(b), 266 U.S. at 681; Rule 38(5)(b), 275 U.S. at 624, 286 U.S. at 624, 306 U.S. at 718-719; Rule 19(1)(b), 346 U.S. at 967-968.

³ Cf. Mem. Op. 2: "Parsons v. Smith, supra, presented the same issue on substantially similar facts."

Whether there would be utility in the promulgation of another opinion by this Court, particularly now after Congress has reinforced the rationale of the Parsons doctrine by legislatively fusing the depletion allowance in the case of coal (Pet. 17-19), is not for us to say. But we are convinced that it is essential to the uniform administration of the Internal Revenue Code for this Court new to indicate in emphatic fashion that principles which it has once enunciated after thorough consideration must be applied and given effect by the lower Federal courts. The present case may accordingly be one where the mere per curiam notation-"Judgment reversed. Parsons v. Smith, 359 U.S. 215"-would be not only appropriate, but illuminating as well. Such a course would indeed "add significantly to a clarification of the law" in an area that only continuing disregard of this Court's decisions has rendered "difficult".

The present petition for certiorari (as well as the petitions in the companion cases, Commissioner v. Merritt et als., No. 237, and Commissioner v. Cooper et al., No. 262) should therefore be granted.

Respectfully submitted.

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JULY 1964.

ELENT CONTROL OF STREET

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IN THE

Supreme Court of the Anited States

OCTOBER TERM, 1964

No. 237

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

ROBERT LEE MERRITT AND WINNIE MERRITT

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

G. WESLEY MERRITT AND FANNIE J. MERRITT

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

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JACK D. MERRITT AND WILLA GRAY MERRITT

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

VIRGIL BOWLING AND GLADYS BOWLING

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

JAMES O. WATSON 3rd AND LUCY J. WATSON

ON PETITION FOR A WRIT OF CERTIORARI TO THE-UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION.

PRELIMINARY STATEMENT

A petition for a writ of certiorari has been filed in Paragon Jewel Coal Company, Inc. v. Commissioner, No. 134. The Commissioner filed a memorandum in opposition in that case and then filed the present petition as a protective measure. This brief is directed to the petition in No. 134, since the petitioner in that case, rather than the Commissioner, is the party whose interests are adverse to respondents.

QUESTION PRESENTED

Respondents, operating as various partnerships, mined coal under non-terminable agreements with the lessee of the mineral lands from whom respondents received a price per ton which varied in accordance with changes in the market price of coal. The question presented is whether respondents are entitled to an allocable share of the percentage depletion allowance based on the amounts they received for coal produced or whether the lessee, Paragon Jewel Coal Company, Inc., is entitled to the entire percentage depletion allowance based on its gross income from the property, undiminished by the amounts paid to respondents.

STATEMENT OF THE CASE

A. Respondents Agreements With Paragon.

C. A. Clyborne acquired by purchase and lease certain coal bearing lands located in Buchanan County, Virginia. In 1951 Clyborne created petitioner, Paragon Jewel Coal Company, Inc. (hereinafter "Paragon"), the corporate stock of which is held almost exclusively by Clyborne and his wife. After Paragon was formed, Clyborne assigned the leases he had acquired to his corporation for an overriding tonnage royalty. This royalty was deducted by Paragon as an operating expense and reported by Clyborne as long-term capital gain. (Merritt App. 9)

Under the assignments Paragon assumed the obligation to pay minimum royalties, tonnage royalties and land taxes, all of which were deducted as business expenses or taxes. Paragon made substantial investments on the properties in order to prepare itself to process, ship and market the coal, all of which were deducted as a business expense, depreciation or amortization of mine development costs. In fact, all expenditures of Paragon with reference to the properties were so deducted for tax purposes. (Merritt App. 12, 46, 47)

Paragon's experience was as a processor and seller of coal rather than a producer; furthermore it lacked the capital to go into the coal producing business. Since the coal mining business is very hazardous, Clybourne did not want to expose his personal funds to the dangers inherent in the coal producing business. Rather than mine the coal itself, Paragon elected to rely on others exclusively for the production of coal and it entered into oral

Respondents filed two briefs and an appendix below. The latter document is entitled "Appendix for Merritt, et al, Petitioners", We have filed nine extra copies thereof with this brief. This appendix will be cited herein as "Merritt App.".

agreements 2 with respondents and others to mine the coal by a method known as drift mining.3 (Merritt App. 29-32, 38, 39).

Beginning in 1951, Paragon entered into oral leases with a number of operators including respondents, all of which were similar in terms. Under such agreements the operator was allocated a specific surface area under which it might mine. The operator agreed to mine the coal within that area and deliver it to Paragon at the operator's own expense. All expenses of opening, developing and operating the mine were to be borne by the operators. Paragon agreed to pay a fixed price per ton of marketable coal, but it was understood that the price would, and in fact it did, vary with the market. The operators were required to use and pay for the services of Paragon's engineer and to operate and maintain their mines in accordance with state and federal mining laws and regulations. The agreements were silent as to who was entitled to depletion. They contained no termination date and nothing was said between the parties on this subject. (Paragon App. A3, A4)

Usually it would require about six weeks of preparatory work before an operator could mine coal. Even then the operation is unprofitable. A drift mine must be developed by driving a main entry, air courses, cross sections and rooms to create enough working areas so that a sufficient daily tonnage can be produced to make the mine profitable. This requires from at least six months.

² In many instances in Buchanan County, Virginia coal leases are oral. It was common practice in that area to transfer coal interests and rights by verbal agreement. (Merritt App. 32-34).

Drift mining is done by driving a horizontal shaft into the hillside and extracting the coal from seams which are usually less than three feet in thickness. It is an underground mining operation, which does not disturb the surface of the land. Drift mining is a difficult and economically marginal operation. (Paragon App. A3)

to a year and often longer. (Merritt App. 57, 58, 61, 62, 67, 83-85, 94).

The operators were encouraged by Paragon to invest in their mining operations so that their mines could be developed and coal produced. Respondent, and the other operators were willing to undertake these burdens because they understood that their operations could not be terminated until they had mined their respective areas to exhaustion and that they would recive a fair per ton price based on the condition of the coal market for the marketable coal they produced. (Merritt App. 91, 92, 97-99)

B. Determination Of The Tax Court.

The Tax Court decided that Paragon was entitled to the entire percentage depletion allowance. Such determination was based on a finding that the contracts did not contain a specific statement that they were not terminable at the will of Paragon and the contracts did not contain a specific statement that the operators had a right to mine to exhaustion. From these facts the Tax Court concluded that as a matter of law the operators did not have such rights under the contracts.

C. Decision Of The Court Of Appeals.

The Court of Appeals disagreed with the conclusions of law of the Tax Court. It held that by virtue of their contracts and the operators' respective expenditures under them, the operators shared with Paragon an economic interest in the mineral within the rationale of *Parsons* v. Smith, 359 U.S. 215.

D. Paragon's Position Before This Court,

Paragon advances three reasons for the granting of its petition. First, it contends that the decision below is in conflict with *Parsons* v. *Smith*, supra; then it claims that

contract mine operators are foreclosed from the depletion allowance by the provisions of Section 631(c) of the 1954 Code; and finally it asserts that the decision below will have serious litigation-breeding consequences.

E. Commissioner's Position On Paragon's Petition For Write of Certiorari.

The Commissioner has filed a memorandum in opposition contending that Paragon's petition should be denied. This memorandum states a belief that the decision of the Court of Appeals is "basically in conflict with Parsons", and refers to the "clear error of the decision below", but no attempt is made to identify the "basic conflict" or set forth the "clear error".

ARGUMENT

A. The Decision Of The Tax Court of Appeals Is Proper And In Accordance With Parsons v. Smith.

Paragon contends that under Parsons v. Smith, supra the depletion allowance is available only to a taxpayer who owns the coal in place. It asserts that the facts "clearly negative any conveyance to the Contractors, or any ownership by them of the coal either in place or after extraction" (Par. Pet. 14); "Very plainly, therefore, the contractors had no property in that coal" (Par. Pet. 15); respondents are not entitled to depletion because they "did not own a single lump of coal when their work commenced, and did not own a single lump when they fine ished" (Par. Pet. 16): "Property, and property alone is the touchstone entitling to depletion" (Par. Pet. 16); and under the rationale of Parsons v. Smith, supra "the deduction for depletion inures only to those who have ownership of and capital investment in the minerals in place" (Par. Pet. 14).

If ownership of the mineral in place were essential to the depletion allowance, Treasury Department Regulations' would so state, but they provide to the contrary. Section 1.611-1 (b) (1) of the regulations under the 1954 Code provides that "Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber." (Par. App. A10) If property is the only touchstone and ownership of the mineral is to control it would be simple to so provide by eliminating the words "an economic interest in."

The regulations adopted as its definition of an "economic interest" the following statement of the Supreme Court in *Palmer* v. *Bender*, 287 U.S. 551:

"The language of the statute is broad enough to provide, at least, for every case in which the tax-payer has acquired by investment, any interest in the oil in place, and secures by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital." (Emphasis supplied)

The presence of such terms as "at least," "for every case", "any interest" and "any form of legal relationship" forecloses any concept that the depletion allowance is available only to the owner of the mineral deposit. Indeed the holding in Palmer v. Bender, supra, was that depletion did not depend upon any special form of legal interest in the mineral deposits. Recent Supreme Court cases reiterate this view. Commissioner v. Southwest Exploration Co., 350 U. S. 308; Parsons v. Smith, 359 U.S. 215.

Thus, under the regulations and decisions of the Supreme Court the essential requirement is not ownership of the coal as Paragon maintains, but ownership of an economic interest in the coal in place.

In Parsons v. Smith, supra, the Supreme Court noted that the language of the regulations with immaterial changes has remained unchanged since 1939.

After reviewing the controlling principles, this Court in Parsons v. Smith, supra, stated:

"By their contracts which were completely terminable without cause on short notice, petitioners simply agreed to provide the equipment and do the work required to strip mine coal from designated lands of the landowners and to deliver the coal to the latter at stated points, and in full consideration for the performance of that undertaking the landowners were to pay to petitioners a fixed sum per ton."

Then the Supreme Court summarized the facts of the two cases before it and decided the case by stating:

"" * "The controlling fact is that [petitioners] had no interest in the [coal] in place." * " petitioners simply entered into contracts, terminable without cause on short notice, with the owners of coal-bearing lands to provide the equipment and do the work required to strip mine and deliver coal from those lands, as independent contractors, for fixed unit prices."

In the case at bar the rights of the operators were not terminable without cause and they were not guaranteed fixed unit prices for the coal they produced. On the contrary, the agreements vested in the operators the continuing right to mine to exhaustion and to be paid as the mineral was extracted a price which was related to the market price of coal. Thus on the vital and controlling facts, this case is in accord with the principles and rationale of *Parsons* v. *Smith*, supra.

Paragon's claim that the Fourth Circuit significantly failed to follow Parsons v. Smith, supra, (Par. Pet. 13) and that Parsons is not law in that Circuit (Par. Pet. 17), is not supported by the facts. Since the Parsons case was decided, that Circuit has considered five cases involving this issue. in each of these cases, that Court has

judiciously adhered to the principles announced by this Court, and it has not merely paid lip service to Parsons.

In the instant case, the Fourth Circuit found that, unlike Parsons v. Smith, supra, the contracts with Paragon vested in the operators a continuing right to mine to exhaustion; they were paid a price for coal closely related to the market price; the contracts were not subject to termination and by their performance and expenditures under these agreements the operators acquired an economic interest in the mineral in place. By assuming and performing Paragon's obligation to mine the property, the operators relieved the lessee of the cost, burden and risk of development and mining and became entitled to a share of the capital reservoir represented by the coal in place. Palmer v. Bender, 287 U.S. 551, 53 S.Ct. 225; G.C.M. 22730, 1941-1 C.B. 214.

In Parsons v. Smith, 359 U.S. 215, this Court decided that the taxpayers claim to depletion was negated by certain facts which were listed at page 225. The facts of the instant case are quite different from those of the Parsons case. The principal investment of respondents was in the coal in place—not in equipment—and consisted of their assuming the obligation of developing their mines and extracting all mineable and marketable coal; their investments were not all recoverable through depreciation; the contracts were not completely terminable without cause on short notice; Paragon, the lessee, did agree to surrender and did actually surrender to the operators a

^{5 1.} United States v. Stallard, 273 F.2d 847

^{2.} McCall v. Commissioner, 312 F.2d 699

^{3.} Elm Development Company v. Commissioner, 315 F.2d 488

^{4.} Cooper v. Commissioner, 330 F.2d 163

^{5.} The instant case.

⁶ The United States Court of Claims in CBN Corporation v. United States, 328 F.2d 316 (1964) at p. 323 cites with approval the Fourth Circuit's decision in Elm Development Company v. Commissioner, supra, stating that it contains an excellent discussion of the subject.

capital interest in the coal in place—that is Paragon surrendered its right to mine the coal itself or to determine whether it is mined or who is to mine it; Paragon agreed to handle all marketable coal and the price to be paid was closely related to the market price of coal; and the operators income was not dependent upon the personal covenant of Paragon without regard to the market price of the coal.

For the reasons stated, it is clear that the decision of the Court below is in accord with Parsons v. Smith and other decisions of this Court.

B. Paragon's Interpretation Of Section 631(c) Of The Internal Revenue Code Of 1954

Paragon insists that respondents are foreclosed from claiming depletion as a result of Section 631(c) of the 1954 Code. The provision relied upon by Paragon was first enacted as Section 325(b) of the Revenue Act of 1951, which amended Section 117(k) (2) of the 1939 Code. It was later carried into the 1954 Code as Section 631(c). The legislative history preceding the amendment of this provision contains nothing which would suggest that Congress intended to make Sections 611(b)(1) inapplicable to coal leases. Moreover, neither the Treasury Department in its regulations or the Government in litigation has placed such an interpretation on this sectioneven though the statute has been in existence for over twelve years. Paragon does not cite any Committee Reports, Treasury Department Rulings or decided cases in support of its interpretation, nor can it do so since all authority is to the contrary.

Section 631(c) provides that in certain situations an owner who disposes of coal under any form or type of contract by virtue of which he retains an economic interest in such coal shall not be entitled to the allowance for percentage depletion, but shall be entitled to treat any gain as long term capital gain. In the case of these own-

ers, Congress substituted one form of tax treatment for another. Congress did not, however, change the principle long recognized by the courts that a number of taxpayers may hold an economic interest in a mineral deposit and share in the depletion allowance. Sections 1.611-1(c) (1) and (2) of the Regulations (Appendix 14) refers to "several owners of economic interests" and "in the case of a lease or other contract providing for the sharing of economic interests in a mineral deposit or standing timber". (Emphasis supplied) These regulations apply to all mineral deposits including coal.

C. Decision Of The Court Of Appeals Will Not Have Serious Litigation-Breeding Consequences.

Paragon's fear that the decision below will cause the volume of depletion litigation to increase is without foundation. The Commissioner of Internal Revenue, who would be most concerned with such an increase, does not share Paragon's fear (Comm'r. Mem. Op. 3). The rationale of Parsons v. Smith, supra, is well understood by contracting parties in the coal fields of Virginia and West Virginia. Agreements entered into subsequent to that decision are clear as to the question of the respective rights of the parties to the depletion allowance. Pending coal depletion cases involve oral agreements which were entered into prior to Parsons v. Smith, supra.

The instant case involves oral agreements made in 1952, 1953, 1954 and 1955 and the companion case of Commissioner v. Cooper et al, No. 262 involves oral agreements made prior to 1953. In both cases the coal mine operators claimed a right to mine a specific area to exhaustion and the lessee coal companies contended that they could terminate the agreements at will and without cause. Other factors indicative of an economic interest in the coal mine operators were not seriously questioned by the lessee coal company in either case.

Section 611 of the 1954 Code provides for a reasonable allowance for depletion, 'according to the peculiar conditions in each case". Paragon is a processor and seller of coal rather than a producer. It had certain production obligations under its lease, but it lacked the capital necessary to engage in the coal producing business. The operators agreed to perform Paragon's obligations under its leases and made large expenditures of time and money in preparing their respective sites for mining and in developing their mines and producing coal. On the basis of these undisputed facts, the Court of Appeals determined that Paragon could not remain silent on the point of termination and then take the benefit of the operators efforts at will and without cause; and that if it intended any limitation on the operators rights the burden was on Paragon to express such limitation.

The Fourth Circuit understands the peculiar conditions in the coal fields of Virginia and West Virginia. It considers legal problems related thereto on a frequent and continuing basis. Prior to Parsons v. Smith, supra, many coal producing agreements in that area were verbal—now such agreements are written and the rights of the parties to the depletion allowance can be easily determined from the contract provisions. Refund claims in large numbers will not be filed. For all but a handful of taxpayers, the question of the depletion allowance on the production of coal has been settled long ago.

CONCLUSION

The petition for writ of certiorari would serve no useful purpose and should therefore be denied.

Respectfully submitted,

John Y. Merrell 844 Shoreham Building Washington, D. C. 20005

August 1964

APPENDIX.

REGULATION

"§ 1.611-1 Allowance of Deduction For Depletion. (a) Depletion of mines, oil and gas wells, other natural deposits, and timber—(1)(c) Special rules— (1) In General. For the purpose of the equitable apportionment of depletion among the several owners of economic interests in a mineral deposit or standing timber, if the value of any mineral or timber must be ascertained as of any specific date for the determination of the basis for depletion, the values of such several interests therein may be determined separately, but, when determined as of the same date, shall together never exceed the value at that date of the mineral or timber as a whole.

"(2) Leases. In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee. In the case of a lease or other contract providing for the sharing of economic interests in a mineral deposit or standing timber, such deduction shall be computed by each taxpayer by reference to the adjusted basis of his property determined in accordance with sections 611 and 612, or computed in accordance with section 613, if applicable, and the regulations thereunder."

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., PETITIONER

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE RESPONDENT

In our Memorandum in Opposition, we stated our agreement with petitioner that the decision below was wrong and basically in conflict with Parsons v. Smith, 359 U.S. 215. We questioned, however, whether the matter was of sufficient importance to warrant resolution by this Court at the present time and concluded "on balance" that it would be appropriate for the Court "to await further developments before undertaking another review of this question." Since the filing of that memorandum, we have had occasion, in connection with proposed legislation, to re-examine the problems created by the decision below. In the course of that re-examination and a considera-

tion of the difficulties of solving the problems legislatively, we have become persuaded that the question is of sufficient dignity to warrant this Court's attention and that a judicial reversal of the decision below would provide the only wholly satisfactory solution to the problems of administration created by it. The purpose of this supplemental memorandum is to advise the Court of the interim developments and of the reasons why we think the case worthy of review.

The decision below was adverse to the interests not only of the government but also of the many lessees (or owners) of coal lands who found themselves in positions similar to Paragon. With their right to the full depletion deduction—which was thought to have been settled by Parsons—being challenged anew. they were understandably unwilling to face another long round of litigation and turned to Congress for a legislative solution. A bill H.R. 7307, 88th Cong.) which would explicitly deny depletion to contract miners under the typical kind of arrangement involved in this case' passed the House on June 24, 1964, and was referred to the Senate Finance Committee on June 30, 1964. On August 4, 1964, the Finance Committee announced that public hearings would be held on the bill.

¹The bill would deny depletion to contract miners if two factors are present, *i.e.*, if the contract miner must deliver all of the mineral extracted to the lessee (or landowner) and if payment is in terms of a fixed sum per unit. See H. Rep. No. 1516, 88th Cong., 2d Sess.

The legislative activity, while emphasizing the need for a resolution of the uncertainties created by the decision below, has also placed in sharp focus the limitations on the tools available to Congress to resolve a problem of this sort. Constitutional limitations aside, retroactive legislation purporting to take a tax benefit away from one party to a past transaction and give it to another is obviously undesirable. Prospective legislation, on the other hand, may solve the question for the future—albeit at the price of adding still another highly particularized provision to an already over-burdened Code—but would not solve it for past periods and would thus fail of the purpose to end litigation of the matter.

Considering the problems presented by the legislative proposals, we have become persuaded that the question merits the attention of this Court and is one that can much better be resolved by the judicial. rather than the legislative, process. Correction of departures from established principles by lower courts is traditionally the function of this Court. and it ought not require an Act of Congress, enrolled as a part of the permanent tax code, to correct an error of a single court of appeals. Since the decision below is, in our view, contrary to the controlling precedents of this Court, review and correction here would impose a minimum burden on this Court's time. On the other hand, it is likely that a denial of certiorari would only postpone, and not avoid, the necessity of reviewing the question. Even were the government willing to acquiesce in the decision

below-as it is not-the lessees would of course not be, and they may be counted upon to bring their suits, if possible, in another forum (e.g., the Court of Claims) in an effort to establish a direct conflict. In the meantime, the government, to protect the revenue, will need to take positions adverse to both parties to prevent the same deduction from being taken twice and in an attempt to keep the cases open pending a final resolution of the question. A substantial number of cases involving the issue are already pending, and the effect of the decision below can only be significantly to increase the quantity of litigation. If, as seems likely, the question would ultimately reach this Court anyway, there is nothing to be lost and much to be gained by disposing of the matter now.

In sum, with the considerations for and against review already closely in balance, the Congressional concern that has been generated by it seems to us to add sufficient stature to this case to warrant its review by this Court. For that reason, and because of the extensive litigation that is threatened to be precipitated by the decision below, we now join with peti-

The Internal Revenue Service indicates that their records show six cases docketed in the Tax Court and four cases docketed in district courts (some involving several taxpayers) which deal with the issue here. In addition, Dotson v. United States, No. 23-62, pends in the Court of Claims and Lawson v. Commissioner, decided June 27, 1963, is on appeal from the Tax Court to the Fourth Circuit. Both raise the question here.

tioner in urging that the petition for certiorari be granted.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
MICHAEL MULRONEY,
Attorney

H.S. GOVERNMENT PRINTING OFFICE:18

SEPTEMBER 1964.

In the Supreme Court of the United States October Term, 1964

No. 237

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ROBERT LEE MERRITT and WINNIE MERRITT, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

On October 12, 1964, the Court granted certiorari in Paragon Jewel Coal Co. v. Commissioner, No. 134, but did not act on the petition in this case, presumably intending to withhold action until Paragon is decided. The purpose of this memorandum is to point out that the result of the Court's action is to place the issue before the Court without an adverse party. In order to provide an adversary proceeding, we suggest that the Court also grant certiorari in this

case and consolidate it for argument with the Para-

gon case.

Respondents in this case are coal miners who, under oral contracts with Paragon, mine coal on lands owned or leased by Paragon and deliver the mined coal to Paragon at a price per ton fixed from time to time by Paragon. It is agreed by all that either the miners or Paragon, but not both, are entitled to percentage depletion deductions on the amounts paid by Paragon to the miners. The single issue in both No. 134 and this case is which party to the contracts is entitled to the depletion deductions. The cases were consolidated in the Tax Court and the court of appeals. The Tax Court gave the deduction to Paragon; the court of appeals, to the miners. The government supported Paragon's position in the court of appeals, and, when Paragon petitioned for certiorari in No. 134, we stated our agreement with it that the court of appeals' decision was wrong and ultimately joined in urging that the petition be granted. At the same time, we filed a petition in this case (i.e., against the miners) conditioned upon the grant of certiorari in Paragon. As noted above, the Court, on October 12, 1964, granted the petition in Paragon but did not act on the petition in this case.

If the Paragon case is argued alone, the upshot, since the government agrees with Paragon, will be that both parties before the Court will be arguing for the same result. The only parties taking the opposite position are the miners who are the respondents in this case. In order that they may be heard,

and the Court have the benefit of a presentation of opposing views, it is respectfully suggested that the Court should also grant the petition in this case and consolidate the cases for argument. We are authorized to advise the Court that respondents concur in that suggestion.

The Paragon case was placed on the summary calendar, and a grant of the petition in this case would therefore require some enlargement of the time allowed for argument even if the cases were consolidated. As a party to both cases, however, the government is willing to waive any right to additional time and to accept a single half-hour as its allotment of time for argument of the consolidated cases.

Respectfully submitted.

ARCHIBALD COX, Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

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OCTOBER 1964.

also filed a conditional petition for certiorari, involves the same question but a wholly separate transaction and different parties. The petition in that case may, therefore, appropriately be held to await the outcome of the *Paragon* case.

LIERARY

Office Supreme Court, U.S. F.J.L. E.D

JAN 4° 1965

IN THE

JOHN F. DAVIS, CLERK'

Supreme Court of the United States

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., Petitioner,

V

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF FOR THE PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., Petitioner,

V

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Tax Court (R. 189-225) is reported at 39 T.C. 257. The opinion of the court below (R. 252-255) is reported at 330 F. 2d 161.

JURISDICTION

The judgment of the court below (R. 256) was entered on March 17, 1964. The petition for a writ of certiorari was filed on June 1, 1964, and granted on October 12, 1964. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

- 1. Whether the decision below nullifies this Court's ruling in *Parsons* v. *Smith*, 359 U.S. 215, which held that the depletion deduction is available only to the owner of a capital interest in mineral in place.
- 2. The Tax Court found as facts that certain taxpayers, mining coal under contract with petitioner, lessee of the coal, (1) had no obligations under petitioner's coal leases and paid no royalties or taxes on the property or the mineral interest; (2) acquired no legal title either to the coal in place or to the coal after it was mined; (3) never acquired any interest in the coal by assignment or sublease from petitioner or by purchase or lease from anyone else; (4) sold none of the coal to anyone other than to the lessee and were not entitled to do so; (5) were not concerned with the sale price the lessee received for the coal; (6) mined only as directed by the lessee; and, on conflicting evidence, (7) had no right to mine any specific area to exhaustion.

The question presented is whether, having regard to the rule of Parsons v. Smith, 359 U.S. 215, where this Court declared that the depletion deduction was available only to the owner of a capital interest in mineral in place, the court below erred in holding that, on the foregoing facts, all of which were inconsistent with any ownership of or capital investment in the coal in place on the part of the contractors, they were none the less entitled to depletion on the footing that they shared an economic interest in the coal with the lessee, petitioner here.

3. Section 611(b)(1), I.R.C. 1954, continuing a provision in force since 1918, provides that, in the case of a lease, the deduction for depletion "shall be equit-

ably apportioned between the lessor and lessee." Section 631(c), I.R.C. 1954, denies the lessor of coal any deduction for depletion, and defines "owner" for the purpose of computing the depletion allowance as any person who owns an economic interest in coal in place, including a sublessor. Section 614(a), I.R.C. 1954, defines "property" for the purpose of computing the depletion allowance in the case of mines as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land." Section 631(b), I.R.C. 1954, defines an "owner" for the purpose of computing the depletion allowance as any person who owns an interest in timber, including a sublessor and a holder of a contract to cut timber.

The question presented is whether, in view of those provisions, there is any warrant in law for the holding below that a lessee of coal must share its depletion allowance with those with whom it has contracted to mine the coal and who plainly were not sublessees.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 1a-8a.

STATEMENT

The following facts were found by the Tax Court:

A. Paragon's leases and its mining contractors

Petitioner, Paragon Jewel Coal Company, Inc. (hereafter "Paragon"), acquired by assignment written leases on the coal in and underlying land in Buchanan County, Virginia. The leases required the lessee to mine either all or 85 per cent of the minable coal in and underlying the leased tracts. Paragon

assumed all the obligations of the lessees under the leases, and was obligated to pay annual minimum royalties, tonnage royalties, and land taxes. (R. 211.) The individuals specified below, who mined the coal under contracts with Paragon, did not assume any of Paragon's obligations under its leases and paid no royalties or taxes on the property or the mineral interest (R. 214) The contractors "acquired no legal title either to the coal in place or to the coal after it was mined" (R. 216).

After acquiring the leases, Paragon made substantial investments necessary for mining, processing and marketing the coal, including the construction and maintenance of a tipple, processing equipment, a power line, a railroad sidetrack with four spurs running under the tipple, and a road from the tipple around the mountain close to the outcrop line of the coal over which coal could be trucked from the mines to the tipple. Paragon did not mine the coal itself, but contracted out the mining to various individuals and firms who were to mine the coal at their own expense and deliver the coal to Paragon's tipple. Paragon would then clean and size the coal and sell it on the market. (R. 211-212.)

Among Paragon's independent contractors were Standard Smokeless Coal Company, whose partners during the period here in question were Robert Lee Merritt, G. Wesley Merritt, James O. Watson, and Jack D. Merritt (R. 212); Kyva Mining Company, a firm composed from time to time of G. Wesley Merritt, Watson and Virgil Bowling (R. 212); Farwest Coal Company, whose partners were Bowling and the three Merritts (R. 212-213), and certain other firms and individuals (R. 212-213):

The three Merritts, Watson, and Bowling, were petitioners in the consolidated proceeding in the Tax Court (R. 189, 190), and were similarly petitioners in the consolidated proceeding in the Fourth Circuit. As will be pointed out below, page 11, the cases of the Merritts and their fellow contractors have now once more been consolidated with Paragon's case in this Court.

B. Paragon's mining contracts

The contracts between Paragon and the several contractors above named were oral, and were performed as follows:

As Paragon extended its road around the side of the mountain, the prospective contractor would be taken to various proposed sites for mine openings, which Paragon would usually face up.1 After the contractor selected a particular site, Paragon's representative would pick out the general area in which the contractor could mine. The contractor agreed to mine the coal in that area and to deliver it to Paragon's tipple at his own expense. The contractor was required to provide his own men and equipment, and, if necessary, to extend a road from Paragon's road to the mine portal. All expenses of opening and operating the mine were borne by the contractor. (R. 213-214.) The contractor agreed either to provide his own power or to purchase it from Paragon, and also agreed to pay Paragon for engineering services inside the mine rendered by Paragon's engineer (R. 214).

Paragon's engineer provided the contractor with a mine map showing the general direction in which the

^{1&}quot;Face up" means to remove the overburden of soil and to expose the seam of coal.

mine should progress, and showing where barriers between adjacent mines should be left so that one contractor did not break through into the mine of the adjacent contractor. The engineer extended the projection from time to time. Paragon insisted on all contractors using the same engineer, who could project a system for mining all the coal under its leases without leaving unrecovered pockets of coal and to prevent one contractor from breaking into the mine of another contractor. The contractors were required to obtain Paragon's permission before pulling pillars as they retreated from an area which had been mined. (R. 214-215.)

The contractors were not obligated to mine any specific amount of coal and were not specifically given the right to mine any particular area to exhaustion. The projections of the mines were based somewhat on the speed with which the contractor worked. If one contractor mined more rapidly, or if an adjacent mine ceased operating, he might be given the right to pierce the indicated barrier. (R. 215-216.)

C. Were the contracts terminable?

The Tax Court found (R. 215) that "The contracts were not made for any specific period of time and nothing was said about the right to terminate by either party at the time the agreements were entered into."

The record contains two exhibits (R. 231-246), both of which were sworn statements submitted by G. Wesley Merritt (one of the respondents in No. 237) to the District Director of Internal Revenue at Richmond, Va., one on behalf of the Kyva Mining Company, the other on behalf of Standard Smokeless Coal Company, the affiant plus his partners in the two firms compris-

ing all of the respondents in No. 237.² In each of these statements, which were sworn to and filed long before the present proceedings were commenced in the Tax Court, it was stated (R. 235, 243) that "The partnership's contract with Paragon embraced the following understanding between the partners and Paragon," listing nine lettered items, of which the last (R. 236, 244) was:

"(i) The contract specified the right of termination by either party at any time, but the question never arose between the partnership and Paragon."

To continue with the Tax Court's findings:

Numerous contractors ceased mining from time to time as they were unable to mine coal profitably or for other reasons. Such contractors were not permitted to remove buildings from the premises but usually took their equipment with them unless it was under lien to Paragon. It was anticipated by both parties that a contractor would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications. (R. 215.)

D. Other provisions of the contracts

Paragon agreed to pay the contractor a fixed price. per ton for coal delivered to its tipple, less 2½ per cent for rejects. It was understood that the price might vary from time to time. The price paid by Paragon to the contractors did vary, depending somewhat on the general trend of market prices for the coal

² Throughout this brief, all references to the respondents in No. 237 are to the contract miners, and do not include their respective wives, who were made parties only because they filed joint returns with their husbands.

over extended periods and to some lesser extent on labor costs. But price changes made by Paragon to the contractors were always prospective and the contractors were notified several days in advance of any price change so that they always knew the price they would get for coal when they delivered it to the tipple. The contractor had no further control over the coal after it was delivered to Paragon, and did not know how or for what price Paragon sold or otherwise disposed of the coal. (R. 214.)

During the years here involved, Paragon took all merchantable coal produced by the various contractors operating on Paragon's leased property and paid the contractors the price fixed by Paragon. Paragon sold very little of its coal under contract and the prices it obtained for coal varied quite frequently. If Paragon was unable to take all of the contractors' coal either because of lack of coal cars or because its tipple was full, the contractor would fill his own bins and then shut down until Paragon could take more coal. (R. 216.)

The contractors completed their obligations under the contracts by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay them so much per ton. The contractors were not concerned with the sales price Paragon received for the coal. (R. 216.)

The contractors paid nothing for the privilege of mining coal other than their investment in equipment, roads, and buildings and their cost in opening the mine and mining the coal. They acquired no legal title either to the coal in place or to the coal after it was mined. The coal as delivered to Paragon's tipple by the contractors was not in a state which was salable to the consumer but had to be washed, graded, and treated

in order to be salable on the consumer market. All such processing was done by Paragon at its processing plant. The contractors sold none of the coal to anyone other than Paragon, and were not entitled to do so. (R. 216.)

E. The depletion issue in the Tax Court

Paragon claimed percentage depletion on its income tax returns for the taxable years ending September 30, 1955, 1956, and 1957. Standard Smokeless and Kyva claimed percentage depletion on their partnership returns for the calendar years 1954, 1955, and 1956. The Commissioner disallowed both sets of deductions, whereupon Paragon and the several partners in Standard Smokeless and Kyva separately filed petitions in the Tax Court contesting the resultant deficiencies. All the petitions were consolidated for hearing. (R. 189, 190, 217.)

The Commissioner took no position in the Tax Court on the depletion issue, the only one now remaining, beyond agreeing that either Paragon or the contractors were entitled to the depletion deduction, but not both (R. 32, 217).

The Tax Court held (R. 217-225) that, under the rule of Parsons v. Smith, 359 U.S. 215, Paragon alone was entitled to the depletion deduction. After making the findings outlined above, the Tax Court said in its opinion (R. 224), "While we cannot find that the right to terminate was specifically mentioned when the agreements were made, neither can we conclude that the agreements were nonterminable.

"On the facts in this case we conclude that the contractors could look only to the difference in their cost of mining the coal and the amount Paragon paid them for a return of their investment, that they made no investment in and acquired no economic interest in the coal in place, and that consequently they are not entitled to depletion on the coal they produced." Decisions were entered accordingly (R. 225-230).

F. Proceedings and holding below: the parties' positions here

The contractors—the Merritta et als.—petitioned for review in the court below, but at that stage the Commissioner abandoned neutrality, and supported Paragon's sole right to the entire depletion allowance. He argued, inter alia (CIR Br. as Resp. 4-19), that the Tax Court correctly held that the Merritt group was not entitled to percentage depletion, and that the Tax Court's findings, which were not clearly erroneous, showed that the Merritt group made no investments in the coal in place that were necessarily reduced as the coal was extracted.

Nonetheless, in order to protect the revenue, the Commissioner filed a cross-petition to review the decision in favor of Paragon, urging his view (CIR, Br. as Petr. 13-14) that "the Tax Court correctly decided this case," and stating that "in the argument below we will only outline briefly our reasons for believing the decision below is correct."

Even so, the court below reversed (R. 256). After substantially rewriting the terms of Paragon's oral agreement with its contractors as those terms had been found by the Tax Court (cf. R. 215-216 and 222-223 with R. 255), the Fourth Circuit concluded (R. 255) that "the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price. By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest

in the mineral which brings them within the rationale of Parsons v. Smith, 359 U.S. 215

Paragon petitioned for a writ of certiorari here, asserting that the Fourth Circuit had completely set aside Parsons v. Smith; the Commissioner, pointing out that Parsons v. Smith "presented the same issue on substantially similar facts," argued that "the decision of the court of appeals is basically in conflict with Parsons," but opposed review "despite the clear error of the decision below" (Memo. Op. 2, 3). On further consideration however, the Commissioner became "persuaded that the question is of sufficient dignity to warrant this Court's attention and that a judicial reversal of the decision below would provide the only wholly satisfactory solution to the problems of administration created by it"; he accordingly joined with Paragon in urging that the petition be granted (Resp. Supp. Memo. 2, 4-5).

Meanwhile the Commissioner had filed a petition to review the judgment below in favor of the Merritts et als. "in order to protect the government's interest should Paragon ultimately prevail" (Pet. 4, No. 237), asking therein that his petition be granted if Paragon's were. When certiorari was granted in Paragon's case without action on the cross-petition (R. 257), the Commissioner pointed out that since he agreed with Paragon that the court of appeals' decision was wrong, it would be necessary to grant his petition against the Merritts in order to bring them before the Court, and thus to make the proceeding one that was adversary in fact (Pet. Supp. Memo., No. 237).

Accordingly, the Court granted the Commissioner's petition, and consolidated both cases for argument (R. 258).

SUMMARY OF ARGUMENT

I.A. From United States v. Ludey, 274 U.S. 295, through United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, this Court has repeatedly ruled that the purpose of the deduction for depletion is to compensate the owner of wasting mineral assets for the part used up in production, so that when the minerals are exhausted, the owner's capital and his capital assets are unimpaired. The emphasis throughout has been on ownership, notably in the very similar recent use of Parsons v. Smith, 359 U.S. 215, where the deduction for depletion was, as here, claimed by parties who had contracts to mine coal, but who could not point to any capital investment in, or surrender to them of capital interest in, the coal in the ground.

B. In the first case where, under the apportionment provision that without substantial change is now § 611 (b) (1) of the 1954 Code, the Court granted a share of the depletion deduction to parties who were neither lessees or lessors, on the footing that they had an economic interest in the unextracted oil, the concept of "economic interest" was qualified and limited by the requirement that it must represent a capital investment in the oil in place. Palmer v. Bender, 287 U.S. 551. "Ownership was essential" (Thomas v. Perkins, 301 U.S. 655, 661), and the language of all subsequent decisions has emphasized the requirement of capital investment.

C. Thereafter "economic interest" was defined as excluding "a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit * * * which suffered depletion" (Helvering v. Bankline Oil Co., 303 U.S. 362), and that differentiation, between an economic interest acquired by making a capital investment in the mineral in the

ground, and a mere economic advantage arising out of a contract to extract that mineral, was promptly carried into the Treasury Regulations, where it still remains, substantially in haec verba. Income Tax Regulations under I.R.C. 1954, § 1.611-1(b)(1).

D. Later cases here, however, involving instances of fractionalized oil and gas interests, were read elsewhere as blurring the foregoing concept of "economic interest," and in Commissioner v. Southwest Exploration Co., 350 U.S. 308, depletion was allowed to the owner of an upland tract, the use of which was indispensible to a drilling operation, even though the upland tract contained no oil. If that case is limited to its facts, it does not help the contractors here, and of course the Court need not reexamine its holding. Contrariwise, the present petitioner feels bound to do so. Careful analysis indicates that Southwest Exploration is inconsistent with both earlier and later cases, because it allowed depletion to parties whose capital assets were neither impaired nor exhausted by the drilling process, and who owned just as much oil at the beginning as at the close of the operation, viz., none whatever. Analysis also shows that in Southwest Exploration there was nothing to indicate a surrender to the upland owners of any capital interest in the oil in the ground. It was this insistence on a surrender of capital interest that led to the doctrinally different result in Parsons v. Smith, 359 U.S. 215, where the Court reemphasized the principle that depletion was intended "to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset."

- E. In any event, the coal cases are far less complicated, because ownership of coal cannot be subdivided to the same extent as in oil and gas. There are only four possibilities: (1) ownership in fee of the land; (2) ownership in fee of the coal, separate from the

surface; (3) lease of the fee including the coal; (4) lease of the underlying coal only. Each of these interests represents a capital investment in the coal in place, and each of these interests can only be transferred or surrendered by an appropriate conveyance or contract to convey. Consequently a party who simply contracts to mine the coal represented by the foregoing interests does not thereby acquire any capital investment in the unmined coal.

F. In view of the controlling principle, reaffirmed and restated in Parsons v. Smith, 359 U.S. 215, that only the owner of a capital investment in the coal in the ground is entitled to the deduction for depletion, since it is his assets alone that become exhausted in the mining process, the terms of the contracts he makes for mining the coal are meaningful only for the light they throw on the issue of ownership. They have no independent significance, and it is a source of error to consider that they do. All of the factors canvassed in Parsons v. Smith to show that the contractors there had no capital investment in the unmined coal are considered, and the irrelevance of the right to mine to exhaustion, which though an issue in that case was not discussed in that opinion, is demonstrated. After all, a contract to cut another's grass in perpetuity does not vest in the man who pushes the lawnmower any proprietary interest in the other party's front yard.

II. Legislation enacted after the tax years considered in *Parsons* v. *Smiths* and which governs the tax years involved in the present case, demonstrates even more clearly than was earlier possible that coal contractors have no right whatever to any deduction for depletion.

A. Sec. 614(a) of the 1954 Code, giving statutory force to an earlier Treasury Regulation, defines "property" for purposes of depletion as "each separate interest owned by the taxpayer in each mineral deposit

in each separate tract or parcel of land." To ask what separate interest, &c., is owned by any coal contractor requires the obvious answer, None; coal contractors have no ownership of the coal either before or after the mining operation.

B. Since 1951, under § 631(c) of the 1954 Code and its predecessor provisions, the lessor of coal lands has been granted capital gains treatment for his royalties but in return has been denied any deduction for depletion. It follows that the provision for apportioning that deduction in the case of leases, now § 611(b)(1), no longer applies to coal leases. Consequently the entire deduction for depletion in the case of coal leases is now granted indivisibly to the lessee, and there remains no basis for any contention that one who simply contracts to mine coal belonging to another has any right to that deduction. After all, the deduction for depletion is a matter of legislative grace, and the coal contractor can point to nothing in the Code to show that Congress has granted him any part thereof.

C. The foregoing analysis is emphasized by the divergence between successive subsections of the present Code. Sec. 631(b), dealing with timber, defines "owner" as "any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber." But § 631(c), which dealt with coal during the tax years now in question, defined "owner" as 'any person who owns an economic interest in coal in place, including a sublessor." And, when Congress in 1964 amended § 631(c) to include domestic iron ore, it continued the definition of ownership in the case of coal or iron ore as "any person who owns an economic interest in coal or iron ore in place," and significantly did not include in that definition the holder of a contract to mine coal or iron ore. Hence Congress once more enacted the words "economic interest" in the restricted and limited sense in which they were first expounded by this Court and carried into the Treasury Regulations, and in the same restricted and limited sense in which the concept of economic interest was restated and reaffirmed in Parsons v. Smith.

Parsons v. Smith, 359 U.S. 215, and the Court's emphasis there on ownership representing a capital investment in the mineral in the ground as the criterion of entitlement to the deduction for depletion.

That disregard is demonstrated in detail by considering the seven factors enumerated by the Court in Parsons, 359 U.S. at 225, as negativing the fictitious assertion made by the contractors there that they had somehow, through their contracts and their expenditures thereunder, acquired an economic interest that represented a capital investment in the unmined coal. Six of those seven factors, described in detail, are clearly present in this case.

While the Tax Court here could not say that the contracts in this case were nonterminable, its failure to find that they were in fact terminable was clearly erroneous, since such failure disregarded sworn ante motam litem statements filed with the Internal Revenue Service on behalf of all the contractors here, affidavits stating that "The contract specified the right of termination by either party at any time, but the question has never arisen between the partners and Paragon" (R. 236, 244).

This case also reflects a further factor not present in Parsons, namely, Paragon's detailed and rigid control over its contractors' mining operations, a control consistent only with its own complete property in the unmined coal, a control completely inconsistent with any property or capital or ownership interest what-

ever on the part of the contractors in such unmined

B. The decision under review likewise disregarded the applicable provisions of the 1954 Internal Revenue Code and its implementing regulations. Indeed, the opinion below, although undertaking to allocate a deduction resting on legislative grace, did not even cite, much less quote or discuss, a single statutory provision.

C. The decision under review marks a reversion to rulings of the court below antedating Parsons v. Smith that permitted parties without any capital investment whatever in the coal in the ground, parties whose only investment was in their equipment or "in the enterprise," to obtain the benefit of the deduction for depletion none the less. Review in Parsons v. Smith was sought here on the footing of conflict with the foregoing line of decision. But after the affirmance in Parsons, the court below reduced to the single item of terminability the seven factors named in Parsons v. Smith, has been astute to distinguish that decision, has never given it ungrudging acceptance, and in the opinion now under review has simply paid it the lip service of citation.

D. Here, as in two other recent coal depletion cases that it decided, the court below has brushed aside findings made by the trier of facts. (1) The court below spoke of "oral leases," in the face of specific findings that negative alike any lease by Paragon to anyone and any lease by anyone to the contractors. (2) The court below blurred the Tax Court's specific findings showing that the contractors received a fixed price for the coal they mined and relied for their compensation solely on Paragon's personal covenant to pay such price.

(3) The court below found a nonterminable right to mine to exhaustion in the face of specific findings to the contrary that explained why no specific tract could ever be assigned to any particular contractor.

E. The decision under review rested its result on a series of semanticized fictions, of which the most significant one was the assertion that, by reason of their expenditures and contracts, the contractors shared an economic interest in the mineral. This was the precise fiction that Parsons rejected; therein lies the basic fallacy of the decision under review; that is why that decision nullifies Parsons v. Smith, 359 U.S. 215.

ARGUMENT.

We agree with the Commissioner that Parsons v. Smith, 359 U.S. 215, "presented the same issue on substantially similar facts," (Mem. Op. 2) as does this case, and that "the decision of the court of appeals is basically in conflict with Parsons" (Mem. Op. 3). But because we think that what the Commissioner accurately characterizes (ibid.) as "the clear error of the decision below" will become more apparent after a review of the governing guidelines, decisional and statutory, we believe that it will be helpful rather than burdensome to the Court if we devote more space to the fundamental principles concerned than would be necessary in an area less clouded over by semantic fog than the field of mineral depletion.

Briefly, it is our view that, under the decisions of this Court, only a party who actually owns a capital interest in the mineral in the ground is entitled to the deduction for depletion, because it is only the owner of the wasting capital asset whose investment in the mineral becomes depleted in the course of its extraction; that the dichotomy between an "economic interest" and an "economic advantage," first formulated by Chief Justice Hughes in Helvering v. Bankline Oil Co., 303 U.S. 362, and set forth in the Commissioner's regulations ever since, is in essence a formulation of the difference between ownership of the

mineral itself and ownership of a contractual right to extract that mineral; that accordingly it is not only unhelpful but actually confusing to concentrate on and thereafter to attribute controlling consequences to particular incidents of the contractual right to extract the mineral in individual cases; and that whatever may be the complications of attempting to draw the line between "economic interest" and "economic advantage" (or, on our formulation, between ownership and contractual right to extract) in situations involving the fractionalized interests characteristic in the oil and gas industry, there is no such complication in the case of coal, where the mineral is either owned in fee or else is divided only between lessor and lessee.

Moreover, in every case of coal mining involving taxable years subsequent to 1951, and here the years in question run from 1954 to 1957, the Internal Revenue Code specifically denied the lessor of coal lands any deduction for depletion (in return for permitting such lessor capital gains treatment of his royalties); necessarily allowed the lessee, who was specifically granted depletion in respect of his interest, the entire indivisible deduction for depletion; hever once named parties contracting to mine coal belonging to others as statutory beneficiaries of the deduction for depletion; and by further unmistakable implication denied any depletion deduction to such parties. Moreover, in 1954 the Internal Revenue Code incorporated into its provisions the concept of ownership as the basis for calculating depletion.

In our view, "the clear error of the decision below" (Mem. Op. 3) involved several factors. First, the court below disregarded the consistent rule laid down here that limited the deduction for depletion to the owner of an interest representing a capital investment

in the mineral in the ground, in a situation where Paragon as lessee either owned the coal outright or else shared that ownership with its lessor. Second, the court below disregarded the provisions of the 1954 Internal Revenue Code that emphasized the importance of ownership and that specifically entitled Paragon to the entire depletion deduction because it was a lessee of coal lands, as well as those provisions of the Code that by outright omission and further necessary implication denied any such deduction to its contractors, respondents in No. 237, who simply had contracts to mine coal for Paragon. Third, the court below completely disregarded the applicable Internal Revenue regulation. Fourth, the court below baldly brushed aside findings of fact made by the Tax Court. Finally, the court below, through what can only be accurately characterized as a series of semantic fictions, found in the contracts to mine coal and the contractors' expenditures thereunder (all of which were deductible under other provisions of the Internal Revenue Code), a transfer or surrender from Paragon to its contractors of Paragon's capital investment in the minerals.

I. ONLY THE OWNER OF A CAPITAL INTEREST IN MINERAL IN THE GROUND IS ENTITLED TO A DEDUCTION FOR PER-CENTAGE DEPLETION, AND CONSEQUENTLY A PARTY WHO SIMPLY HAS CONTRACTED TO MINE COAL BELONG-ING TO ANOTHER HAS NO RIGHT TO THAT DEDUCTION

In connection with the foregoing heading, we are of course aware that this Court has more generally used the expression "mineral in place"; we would normally do so also; but since discussions with some of the Commissioner's lawyers have suggested that the words "in place" do not convey an exact meaning to all concerned, we are substituting "mineral in the

ground" in our effort to clarify and to eliminate any possible suggestion of semanticism. Accord, United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 88.

A. From United States v. Ludey. 274 U.S. 295, through United States v. Cannelton Sewer Pipe Co., 364 U.S. 78, this Court has emphasized that depletion is an allowance made to the owner for the exhaustion of capital assets.

We shall obviate the enumeration of a long series of cases that formulate the basic criterion for entitlement to the depletion deduction by merely quoting a key passage from Parsons v. Smith, 359 U.S. 215, 220:

"The purpose of the deduction for depletion is plain and has been many times declared by this Court. 'It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compenstion to the owner for the part used up in production.' Helvering v. Bankline Oil Co., 303 U.S. 362, 366. And see United States v. Ludey, 274 U.S. 295, 302; Helvering v. Elbe Oil Land Development Co., 303 U.S. 372, 375; Anderson v. Helvering, 310 U.S. 404, 408; Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 603. '[The depletion] exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired.' Commissioner v. Southwest Exploration Co., 350 U.S. 308, 312. Save for its application only to gross income from mineral deposits and standing timber, the purpose of the deduction for depletion does not differ from the deduction for depreciation. United States v. Ludey, 274 U.S., at 303. In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset."

It will be noted that the word "owner" is used no less than three times in the foregoing quotation. We

emphasize that circumstance, because, as will be demonstrated below in the course of the argument, the importance of ownership has since been emphasized by the terms of I.R.C. 1954, § 614(a) (infra, p. 3a), while, contrariwise, failure to concentrate on ownership underlies most of the confusion and all of the error in the depletion decisions.

And, in the only full discussion of depletion since Parsons v. Smith, the Court once more emphasized ownership by concentrating on "capital assets." See United States v. Cannelton Sewer Pipe Co., 364 U.S. 76.81, 86, 88:

"In summary, mineral depletion for tax purposes is an allowance from income for the exhaustion of capital assets. Anderson v. Helvering, 310 U.S. 404 (1940).

"Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator."

"Depletion, as we read the legislative history, was designed not to recompense for costs of recovery but for exhaustion of mineral assets alone."

Perhaps this would be as good a place as any to point out that this brief discusses only entitlement to the percentage depletion allowance granted by §§ 611, 613, 614, and 631, I.R.C. 1954 (infra, pp. 1a-7a) and their statutory predecessors. We do not undertake to trace the statutory development of the depletion allowance that culminated in the present method of percentage depletion, a development fully set forth in United States v. Dakota-Montana Oil Co., 288 U.S. 459, 460-461, and in Helvering v. Twin Bell Oil Syndicate, 293 U.S. 312, 315-318.

B. The term "economic interest" when first used was accordingly limited to a property interest that represented a capital investment in the mineral in the ground.

In the first income tax act passed after the adoption of the Sixteenth Amendment, Congress lumped depreciation and depletion under a single heading, no doubt because, as this Court later said in *United States Ludey*, 274 U.S. 295, 303, quoted with approval in Parsons v. Smith, 359 U.S. 215, 220, supra, p. 21, "In essence, the deduction for depletion does not differ from the deduction for depreciation."

Thereafter, beginning with the Revenue Act of 1918 and continuously since then, the depletion provisions of successive Internal Revenue Acts have provided, with scarcely any change in phraseology, that—quoting now from § 611(b)(1), 4.R.C. 1954 (infra, p. 1a):

"In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee."

Under § 23(m), I.R.C. 1939; § 23(m) of the Revenue Acts of 1938, 1936, and 1934; and § 23(1), Revenue Act of 1932, the language was, 'In the case of leases, the deductions shall be equitably apportioned between the lessor and lessee.'

In § 23(1) of the Revenue Act of 1928, the word was "deduc-

tion" in the singular.

In § 214(a) (9) of the Revenue Acts of 1926 and 1924 and in § 214(a) (10) of the Revenue Acts of 1921 and 1918, the provision read: "In the case of leases, the deductions allowed by this paragraph shall be equitably apportioned between the lessor and the lessee."

At the present time, see Point II below, pp. 61-65; there is no longer any apportionment in the case of coal leases, but that development need not be dealt with at this juncture.

In the case of oil wells, where division and indeed fractionalization of the mineral interests involved represents a frequent and perhaps even the usual practice, it soon became apparent that a rigid application of conventional common law estates might work injustice. Accordingly, in Palmer v. Bender, 287 U.S. 551, this Court held that, where the owner of an oil or gas lease transferred his lease to another in consideration of a bonus and royalties, the bonus so received was a return pro tanto of the transferor's capital investment in the oil, which entitled the transferor to a depletion allowance.

The Court, per Stone, J., said (287 U.S. at 558):

"In the present case the two partnerships acquired, by the leases to them, complete legal control of the oil in place. Even though legal ownership of it, in a technical sense, remained in their lessor, they, as lessees, nevertheless acquired an economic interest in it which represented their capital investment and was subject to depletion under the statute. Lynch v. Alworth-Stephens Co. [267 U.S. 364] * * *. When the two lessees transferred their operating rights to the two oil companies, whether they became technical sublessors or not, they retained, by their stipulations for royalties, an economic interest in the oil, in place, identical with that of a lessor. Burnet v. Harmel [287 U.S. 103]; Bankers Pocahantas Coal Co. v. Burnet [287 U.S. 308] * * *. throughout their changing relationships with respect to the properties, the oil in the ground was a reservoir of capital investment of the several

parties, all of whom, the original lessors, the two partnerships and their transferees, were entitled to share in the oil produced. Production and sale of the oil would result in its depletion and also in a return of capital investment to the parties according to their respective interests. The loss or destruction of the oil at any time from the date of the leases until complete extraction would have resulted in loss to the partnerships. Such an interest is, we think, included within the meaning and purpose of the statute permitting deduction in the case of oil and gas wells of a reasonable allowance for depletion according to the peculiar conditions in each case."

The foregoing passage is set forth in full, because it was the first to use the expression "economic interest." When those two words were later used without the limiting qualifications of the original formulation, the results unsettled and indeed distorted the entire depletion concept. Accordingly, we have quoted liberally from the source, in order to demonstrate that the entire emphasis there was on an economic interest representing a capital investment in the oil in place, i.e., in the ground. There is no warrant whatever in Palmer v. Bender for the notion of some of the later decisions, primarily those of the court whose decision is here being reviewed, that either an economic interest at large or even an economic interest in the enterprise is sufficient for entitlement to the deduction for depletion.

For, as the Court said in Thomas v. Perkins, 301 U.S. 655, 661,

"If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. Ownership was essential."

We have added the italics by way of stressing the fundamental ownership guideline.

More recently in *Parsons* v. *Smith*, 359 U.S. 215, the Court reiterated the correctness of the capital-investment-in-the-oil-in-place limitation on the concept of "economic interest." It said (359 U.S. at 221-222, note 7):

"The principles declared in the Palmer case have been recognized and applied by every subsequent decision of this Court that has treated with the subject.

"Helvering v. Bankline Oil Co., 303 U.S. 362, 367, literally adopted the language of the Palmer case upon the point."

"In Helvering v. O'Donnell, 303 U.S. 370, 371, it was said: 'The question is whether respondent had an interest, that is, a capital investment, in the oil and gas in place. . . . Palmer v. Bender, 287 U.S. 551, 557; Helvering v. Twin Bell Oil Syndicate, 293 U.S. 312, 321; Thomas v. Perkins, 301 U.S. 655, 661; Helvering v. Bankline Oil Co., supra.'

"Helvering v. Elbe Oil Land Development Co., 303 U.S. 372, 375-376, declared that 'The words "gross income from the property," as used in the statute governing the allowance for depletion, mean gross income received from the operation of the oil and gas wells by one who has a capital investment therein,—not income from the sale of the oil and gas properties themselves.'

"Anderson v. Helvering, 310 U.S. 404, 408-409, repeated the statement last quoted.

"In Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 603, the Court said: 'The test of the right to depletion is whether the taxpayer has a

capital investment in the oil in place which is necessarily reduced as the oil is extracted.'

"In Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 32, the Court said: 'It seems generally accepted that it is the owner of a capital investment or economic interest in the oil in place who is entitled to the depletion.'".

C. The depletion allowance is consequently not available to one who has simply contracted with the owner of the mineral deposit for its extraction.

In Helvering v. Bankline Oil Co., 303 U.S. 362, decided five terms after Palmer v. Bender, this Court reviewed the cases, and, in a situation where the tax-payer had merely a contract with the owner of natural gas wells to extract the gasoline therefrom and to pay one third of the total proceeds of the sale of such gasoline to the owner, or, at the latter's option, to deliver one third of such gasoline to the owner, the taxpayer was not entitled to depletion because he had no capital investment in the natural gas in the ground.

Speaking through Chief Justice Hughes, the Court said (303 U.S. at 366-367, 368):

"In order to determine whether respondent is entitled to depletion with respect to the production in question, we must recur to the fundamental purpose of the statutory allowance. The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. United States v. Ludey, 274 U.S. 295, 302. The granting of an arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance. United States

v. Dakota-Montana Oil Co., 288 U.S. 459, 467. The percentage is 'of the gross income from the property',—a phrase which 'points only to the gross income from oil and gas'. Helvering v. Twin Bell Syndicate, 293 U.S. 312, 321. The allowance is to the recipients of this gross income by reason of their capital investment in the oil or gas in place. Palmer v. Bender, 287 U.S. 551, 557.

"It is true that the right to the depletion allowance does not depend upon any 'particular form of legal interest in the mineral content of the land'. We have said, with reference to oil wells, that it is enough if one 'has an economic interest in the oil, in place, which is depleted by production'; that 'the language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital'. Palmer v. Bender, supras But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit. See Thomas' v. Perkins, 301 U.S. 655, 661.

"Undoubtedly, respondent through its contracts obtained an economic advantage from the production of the gas, but that is not sufficient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance."

The Bankline Oil case was decided in March 1938. The differentiation therein made, between an economic

interest acquired by making a capital investment in the mineral in the ground, and a mere economic advantage that arose out of a contract to extract that mineral, was not reflected in the regulations promulgated on July 15, 1938, to implement the Revenue Act of 1938 (Treas. Regs. 101, Art. 23(m)-1), but it was copied almost verbatim from the Bankline Oil opinion into the first regulations under the Internal Revenue Code of 1939 (Treas. Reg. 103, § 19.23(m)-1, dated August 23, 1939). Since then, there have been no major changes in the economic-interest versus economic-advantage paragraph (Treas. Reg. 111, § 29.23(m)-1; Treas. Reg. 118, § 39.23(m)-1(a) and (b)), and, for the tax years in question in the present case, the applicable provision was § 1.611-1(b)(1) of the Regulations under I.R.C. 1954, as follows (italics added):

"(b) Economic interest. (1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possess a mere economic or pecuniary advantage derived from production. For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not

convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders."

The foregoing language is entirely consistent with the thrust of Paragon's argument here, namely, that the depletion deduction inures to the owner of the mineral, not to the person who has merely contracted to extract that mineral. And, as we shall demonstrate below at the proper place, the foregoing language is entirely inconsistent with the result reached below in this case.

D. The transition from the criterion of an economic interest representing a capital investment in the mineral in the ground to that of an economic interest in the mining or drilling operation, which is indeed reflected in some intermediate decisions, results in granting a depletion allowance to one who had no mineral investment to deplete, and whose investment, being in non-mineral property, was recoverable through the allowance for depreciation or otherwise to the extent that it was used up in the process of extraction.

We turn now to the depletion cases decided after Helvering v. Bankline Oil Co., 303 U.S. 362, and before Parsons v. Smith, 359 U.S. 215. Those in this Court dealt with depletion rights in oil and gas cases, those in the courts of appeals primarily with coal mining situations, but virtually all of them blurred the distinction that had been drawn in the Bankline case and that from thence was carried into the regulations.

(1) The oll and gas cases here through the 1945 Term.

Two other cases were decided by this Court on the same day as Bankline Oil, followed it, and were consistent with its teaching. Helvering v. O'Donnell, 303 U.S. 370; Helvering v. Elbe Oil Land Co., 303 U.S. 372.

A few years later, however, the discussion in Anderson v. Helvering, 310 U.S. 404, did little to clarify matters, and at the 1945 Term there was laid down a foundation of confusion on the strength of which the lower courts, notably the court below, completely altered the concept of "economic interest," so that, for an economic interest that represented a capital investment in the mineral in the ground, there was substituted the wholly different criterion of an economic interest representing an investment in the mining enterprise, generally in machinery and equipment, an investment that was of course independently recoverable through the allowance for depreciation.

Thus, in Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, the Court found it necessary to "explain" no less than three earlier decisions (Anderson v. Helvering, Helvering v. O'Donnell, and Helvering v. Elbe Oil Land Co., all supra), while in the second depletion case of the 1945 Term, Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, the prevailing opinion was occupied with extensive "explanations" of one of those same earlier decisions that that Court had just finished "explaining" in Kirby Petroleum only a few months earlier (Helvering v. Elbe Oil Land Co., supra).

This circumstance prompted one member of the Court in Burton-Sutton, to say (328 U.S. at 38),

"Nothing better illustrates the gossamer lines that have been drawn by this Court in tax cases than the distinction made in the Court's opinion between Helvering v. Elbe Oil Land Co., 303 U.S. 372, and this case. To draw such distinctions, which hardly can be held in the mind longer than it takes to state them, does not achieve the attainable certainty that is such a desideratum in tax matters, nor does it make generally for respect of law."

We shall not in the present coal case venture a reconciliation of the foregoing oil and gas cases, if indeed they can all be reconciled. It is sufficient to note here that, because of the illness of counsel, Burton-Sutton went unargued for the Government (J. Sup. Ct., Oct. T. 1945, pp. 195, 196, 199): No doubt the case was not intended to mark a new departure. But if, as many judges have insisted, "cases that are not argued are not well decided," compare this Court's Rule 45(1), then Burton-Sutton is living proof of the proposition. It was read elsewhere to reflect doctrinal fission here. and certainly it set off a chain reaction in the lower courts, particularly in the court below, which, in a series of decisions that we discuss later on (Point III C, infra, pp. 85-90), relied on Burton-Sutton to allow depletion to mere contractors in coal mining cases, parties with not a penny invested in the coal in the ground, parties whose entire investment was in machinery. The latter decisions changed completely the basic concept and rationale of the mineral depletion allowance, and the opinion now under review shows that, notwithstanding Parsons v. Smith, their ghost has not yet been laid.

We pass the later oil and gas cases here for the further reason, also to be developed in more detail below, that the fractionalization of interests and the complex transactions so characteristic in the usual oil and gas situation, never appear in the coal cases. Briefly, in coal mining there are never more than three interests, and frequently only two: There is the owner of the fee in the coal deposits, who may or may not own the surface of the soil in addition. In either situation, the owner of the coal may convey or lease the mineral interest therein to another and either the owner of the

entire fee, or the owner of the coal, or the lessee of the mineral may arrange for independent contractors to mine the coal.

(2) The Southwest Exploration case.

(i) Its facts and holding. Just a few years before the decision in Parsons v. Smith, 359 U.S. 215, the Court decided Commissioner v. Southwest Exploration Co., 350 U.S. 308.

. Two cases were actually involved there, that of the Southwest Exploration Company, which was doing the actual drilling of offshore oil deposits under a lease from the State of California, and that of the Huntington Beach Company and its associates, the owners of the indispensable upland property from which the drilling was done, and without the use of which drilling was impossible. "Southwest agreed to pay to such owners 241/2% of the net profits for the use of their land." 350 U.S. at 309. The Ninth Circuit, affirming the Tax Court, had granted Southwest Exploration full depletion, for the reason that Huntington had no capital interest in and no capital investment in the oil and gas in the ground. Commissioner v. Southwest Exploration Co., 220 F. 2d 58 (C.A. 9), affirming 18 T.C. 961. The Court of Claims, disagreeing, had allowed Huntington's claim for depletion, on the ground that it had "an economic interest in the production of the oil." Huntington Beach Co. v. United States, 132 C. Cls. 427, 433, 132 F. Supp. 718, 721. This Court, reviewing both cases, held Huntington entitled to depletion, saying (350 U.S. at 317):

"We decide only that where, in the circumstances of this case, a party essential to the drilling for and extraction of oil has made an indispensable contribution of the use of real property adjacent to the oil deposits in return for a share in the netprofits from the production of oil, that party has an economic interest which entitles him to depletion on the income thus received."

If Southwest Exploration were thus imited to its precise facts, it would not help the respondents in No. 237, who very plainly cannot bring themselves within its narrow ambit. This Court can accordingly defer reconsideration of that decision until the same factual situation again arises. If we were similarly to avoid further discussion of the decision, our path would be easier—and assuredly our present brief would be substantially shortened.

But the temptation thus to take the easy road of expediency cannot be indulged. Not only is Southwest Exploration still being invoked by our adversaries to defend the palpably erroneous result reached below in the present case (Br. Op., No. 237, p. 7), but, primarily, that decision runs counter to our formulation and counter to this Court's repeated formulation, of a consistent, logical, and easily applicable rationale of the depletion deduction.

Even as limited, the reasoning of Southwest Exploration is inconsistent with both the earlier and the later depletion cases here, because it reached its result on an essentially fictitious basis—strictures that can easily be documented. At any rate, we are convinced that candor and advocacy join in requiring us to grasp the nettle firmly, and, in full and frank discussion, to undertake to draw its sting.

(ii) Was Southwest Exploration consistent with earlier cases? The statutory allowance for depletion,

said Mr. Chief Justice Hughes in the Bankline Oil case. "is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." 303 U.S. at 366. We have added the italics, in order to ask the question. Just what mineral deposits did Huntington of the indispensable uplands own that were used up in production? True, Huntington made a contribution to the mining venture without which mining would not have been possible, but Huntington's property was not depleted, since it owned just as much oil at the start of the operation as at the endwhich is to say, not a single drop. The incontrovertible fact is that nothing owned by Huntington was depleted in the slightest or would ever be depleted, and that its agreement whereby its contribution of nondepletable and undepleted real estate was compensated simply gave it a percentage of the net profits to be realized from the drilling operation. Under Bankline and the Treasury Regulations couched in Bankline language, that agreement gave it only an economic advantage, a profitable contractual right arising out of the drilling.

(iii) The rationale of Southwest Exploration. A short paragraph from the Court's opinion exposes the reasons underlying its results (350 U.S. at 316):

"Proximity to the offshore oil deposits and effect of the state law combined to make the upland owners essential parties to any drilling operations. This controlling position greatly enhanced the value of their land when extraction of oil from the State's offshore fields became a possibility. The owners might have realized this value by selling their interest for a stated sum and no problem of depletion would have been presented. But instead they chose to contribute the use of their land in return for rental based on a share of net profits. This contribution was an investment in the oil in place sufficient to establish their economic interest. Their income was dependent entirely on production, and the value of their interest decreased with each barrel of oil produced. No more is required by any of the earlier cases."

The key sentence in the foregoing passage—"This contribution was an investment in the oil in place sufficient to establish their economic interest"—is, we respectfully submit, sheerest fiction. One can only invest in oil in place—oil in the ground—by becoming an owner or part owner of that oil. All Huntington owned was land containing no oil whatever. It is ownership that represents the essential capital investment, just as it is ownership of the wasting mineral asset that underlies entitlement to the depletion allowance. And surely to have added, see the quotation, that "No more is required by any of the earlier cases," involved either a thoroughgoing misreading or an obvious overlooking both of Bankline and of Thomas v. Perkins, 301 U.S. 655, 661 (quoted above at p. 25).

(iv) Has the rationale of Southwest Exploration been followed since? It is true that Southwest Exploration was duly cited in Parsons v. Smith, 359 U.S. 215, no less than four times (p. 219, note 5; p. 220, twice; p. 222, note 7). Much language from Southwest Exploration was indeed quoted in Parsons that is entirely consistent with the holdings of Parsons and of many of the earlier cases. But the approach and much of the reasoning of Southwest Exploration are at the very least difficult to reconcile with Parsons—as we shall now show.

- (a) In Huss v. Smith, 255 F. 2d 599 (C.A. 3), the other case dealt with in the Parsons opinion here, Judge Kalodner dissented below, citing Southwest Exploration for the proposition that "No money need be invested in the mineral deposit" (255 F. 2d at 603). Both sets of petitioners in the Parsons case relied heavily on Southwest Exploration for the same proposition (Pet. Br., No. 218, Oct. T. 1958, pp. 10-13; Pet. Br., No. 305, Oct. T. 1958, pp. 14-16).
- (b) Inasmuch as the upland owners in Southwest Exploration had no capital investment whatever in any of the oil being extracted (their capital investment being in their own nonproducing upland); inasmuch as their own capital asset property was in no sense being depleted because at the end of the operation they would still own just as much oil as at the beginning, which is to say, not even a cupful; and inasmuch as the drilling company did not agree to surrender and did not actually surrender to Huntington any of their capital interest in the oil in place that they had leased from the state, it seems plain that the holding in Southwest Exploration cannot be squared with the re-emphasis on the necessity for capital investment that permeates the Parsons opinion. Once attention is concentrated on the basic principle restated in Parsons that "the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset" (359 U.S. at 220), it follows that there is no longer any support for Southwest Exploration, since, obviously, the upland owner did not own any interest in the oil that was being pumped out of the wells. Consequently, however much the two cases may be distinguished on their facts, their divergent reasoning cannot fairly stand together.

(c) It may be helpful also, by way of further demonstrating the essential inconsistency between Southwest Exploration and Parsons, to retrace the steps whereby the Court reached the conclusion in the earlier case that the non-owner of the oil nonetheless had a capital investment in the oil, and in the later one that the non-owner of the coal had no capital investment in the coal. Here are the successive passages:

Southwest Exploration (350 U.S. at 316):

"Recognizing that the law of depletion requires an economic rather than a legal interest in the oil in place, we may proceed to the question of whether the upland owners had such an economic interest here. We find that they did. Proximity to the offshore oil deposits and effect of the state law combined to make the upland owners essential parties to any drilling operations. This controlling position greatly enhanced the value of their land when extraction of oil from the State's offshore fields became a possibility. The owners might have realized this value by selling their interest for a stated sum and no problem of depletion would have been presented. But instead they chose to contribute the use of their land in return for rental based on a share of net profits. This contribution was an investment in the oil in place sufficient to establish their economic interest. Their income was dependent entirely on production, and the value of their interest decreased with each barrel of oil produced."

Parsons (359 U.S. at 224-225):

"It stands admitted that before and apart from their contracts, petitioners had no investment or interest in the coal in place. Their asserted right to the deduction rests entirely upon their contracts. Is there anything in those contracts to indicate that petitioners made a capital investment in, or acquired an economic interest in, the coal in place, as distinguished from the acquisition of a mere economic advantage to be derived from their mining operations? We think it is quite plain that there is not.

"By their contracts, which were completely terminable without cause on short notice, petitioners simply agreed to provide the equipment and do the work required to strip mine coal from designated lands of the landowners and to deliver the coal to the latter at stated points, and in full consideration for performance of that undertaking the landowners were to pay to petitioners a fixed sum per ton. Surely those agreements do not show or suggest that petitioners actually made any capital investment in the coal in place, or that the landowners were to or actually did in any way surrender to petitioners any part of their capital interest in the coal in place. Petitioners do not factually assert otherwise. Their claim to the contrary is based wholly upon an asserted legal fiction. As stated, they claim that their contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place. But that fiction cannot be indulged here. for it is negated by the facts."

The difference in these two approaches lies in the concentration of the second one on its inquiry whether there was any transfer of the ownership of the mineral. Prior to the making of the respective contracts, Huntington in the first case, like Parsons and Huss in the second, had no interest in the mineral, either by way of "economic interest" or of any other kind of interest. But in the first case the Court said that when

Huntington et al. contributed the use of their land, "their contribution was an investment in the oil in place sufficient to establish their economic interest," while in the second the Court pointed out that the stripping contracts of Parsons and Huss "do not show or suggest that petitioners actually made any capital investment in the coal in place, or that the landowners were to or actually did surrender to petitioners any part of their capital interest in the coal in place."

The sentence just quoted from Southwest Exploration, when set against the first clause of the sentence from Parsons, probably does not advance the argument beyond "I am" "You're not" "I am too." But the second clause in the Parsons sentence is really the nub of the matter and underscores the fallacy of Southwest Exploration: Where and how did the Southwest Exploration Company, the drilling concern that held the oil lease, ever surrender or transfer any part of its estate in the oil to Huntington? Of course it never did, in any manner or by any means; indeed, it is the absence of any such surrender or transfer that underlies the fiction inherent in the Southwest Exploration decision, a fiction that the Court in Parsons advisedly refused to follow.

(d) The Court's latest reasoned pronouncement in the depletion area, United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, is similarly at variance with the reasoning of Southwest Exploration. In Cannelton, the Court repeatedly pointed out the purpose of mineral depletion—"an allowance from income for the exhaustion of capital assets" (pp. 81, 86), "designed not to recompense for costs of recovery but for exhaustion of mineral assets alone" (p. 88). Surely the Cannelton approach cannot rationally be reconciled

with the decision in Southwest Exploration, which allowed depletion to the upland owners, whose only capital asset, the upland property, was never exhausted in any respect, and which could not possibly be exhausted by the extraction of oil from another's land, no matter how long continued.

(v) How explain the result in Southwest Exploration? As has been indicated above at page 33, both the upland owner as well the lessee of the oil were before the Court in Southwest Exploration. The government, which had necessarily taken inconsistent litigating positions below in order to protect the revenue, was only a stakeholder in this Court. But it threw its weight into the scales against the drilling company, and here urged that depletion be allowed the upland owner. It summarized its arguments in this Court as follows (Pet. Br., No. 286, Oct. T. 1955, pp. 11-12 [our italics]):

"The reasons relied on by the courts below for their conclusion that the upland owners lacked a depletable interest are not persuasive. Thus, the facts that the upland owners did not have legal title to the deposits, did not have the right to produce oil and gas and did not make a cash investment in the mineral deposits, do not furnish a solid basis for the conclusion that the upland owners did not have a depletable interest. Indeed, the decisions of this Court uniformly demonstrate that these are not sufficient reasons for denying the upland owners the depletion deduction.

"If the Court disagrees with our contention * * *
that the upland owners' right to share in the taxpayer's net profits was a depletable interest because
the upland owners made a contribution of the use
of their property which was essential to the pro-

duction of oil and gas, we urge, alternatively, that it be held that the upland owners acquired a depletable interest merely from the fact that they became entitled to share in the operator's net profit. It would be a logical extension of the principles applied in Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, and Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, to hold that any person who acquires the right to share in the net profits derived from the production of oil and gas has a depletable interest, and that it is immaterial how that interest was acquired * * *. While the broad rule for which we here contend cannot be reconciled with the decisions in Helvering v. O'Donnell, 303 U.S. 370, and Helvering v. Elbe Oil Land Company, 303 U.S. 372, it is believed that those decisions are out of harmony with the Kirby and Burton-Sutton cases and should be regarded as no longer authoritative."

The foregoing excerpt shows two departures from approved doctrine. First, the Government's willingness "to hold that any person who acquires the right to share in the net profits derived from the production of oil and gas has a depletable interest" reflects a complete abandonment of the guidelines governing depletion that had originally been laid down by judges of the stature of Mr. Justice Brandeis, Mr. Justice Stone, and Mr. Chief Justice Hughes, in, respectively, United States v. Ludey, 274 U.S. 295, Palmer v. Bender, 287 U.S. 551, and Helvering v. Bankline Oil Co., 303 U.S. 362. Second, the Government's brushing aside as immaterial of the circumstance that the upland owners "did not make a cash investment in the mineral deposits" involves a rejection of similar guidelines that were later reaffirmed in Parsons v. Smith, 359 U.S. 215, and again in United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, viz., the rule that depletion is an allowance

to permit a recoupment of the owner's capital investment in wasting assets, that it is an allowance for the exhaustion of capital assets. Both of these departures may well have contributed significantly to the strange result reached in *Southwest Exploration*.

(vi) How should Southwest Exploration now be treated? If the Southwest Exploration case were actually read as being strictly limited to its particular and unique facts, it might, as we have said, be left undisturbed until its precise situation once more arose. Similarly, if it concerned simply another manifestation of an ingenious splitting up of property interests in oil and gas, its resolution could also be left to another day. But, just as most decisions have a sweep beyond their original confines, so Southwest Exploration has invaded the coal field. Thus, in a recent case decided by the Sixth Circuit, Omer v. United States, 329 F. 2d 393, where it was held that the owner of the surface overlying the coal lands belonging to others was not entitled in respect of his royalties to capital gains treatment under I.R.C. 1954, § 631(c) (infra, p. 4a), the Government none the less still stipulated a depletion allowance to the owner of the surface 329 F. 2d at 395, note 2):

"The brief of appellee contains the following explanation of this allowance: 'Because of the apparent hardship to the taxpayers in view of the probable destruction of their land by the stripminging operation and because Southwest Expl. Co. may possibly justify a conclusion that the taxpayers acquired an economic interest in the coal in place in the transaction with Badgett, the Commissioner conceded in the District Court that the taxpayers are entitled to a depletion allowance. That concession has been taken into account in the judgment."

The discussion above—the rather lengthy discussion above, we fear-will have made it entirely clear that the result in Southwest Exploration cannot fairly be reconciled with the shaping decisions in Ludey, Palmer. and Bankline on the purpose and scope of the depletion allowance. It seems to us similarly clear that the discussion in Southwest Exploration, which manfully attempted to rationalize and to reconcile the later decisions, from the 310th through the 328th U.S., so far concentrated on the distinctions and explanations made therein that, unavoidably, the contours of the basic depletion concept became not only blurred but actually distorted because that concept had become enshrouded in a veritable fog of words. Finally, we think it clear that the restatement in Parsons of the basis of the depletion allowance, in the terms originally used by this Court, with the emphasis on transfer of ownership. on capital investment in mineral in the ground, and on the depleting mineral asset, as well as the repeated reassertion in Cannelton that depletion "is an allowance for the exhaustion of capital assets," combine to demonstrate that Southwest Exploration, which indeed allowed depletion to one who never owned any mineral and whose property was never exhausted by mining. constituted "a departure from theretofore established principles" (Sonneborn Bros. v. Cureton, 262 U.S. 506, 520).

The formulation of the reasons' justifying the allowance for depletion, made by Chief Justice Hughes in Bankline, and repeated in Parsons, "is as strong today as when it was written, and it would be a source of confusion and injustice if, through too broad expressions in a few opinions, a different conclusion from that to which it should carry us were to obtain"

(Sonneborn Bros. v. Cureton, 262 U.S. at 521). In short, we believe that Southwest Exploration "can no longer be guiding" (Rochester Tel. Corp. v. United States, 307 U.S. 125, 143), and that accordingly it may now appropriately "be allowed a deserved repose" (Adkins v. Children's Hospital, 261 U.S. 525, 567, 570).

E. An economic interest representing a capital investment incoal in the ground can be acquired only by appropriate conveyance or contract to convey.

When we turn to the problem of the present case, which involves the entitlement to the depletion deduction for coal, we are no longer concerned with the fractionalization of interests and the complexity of arrangements that is so characteristic of oil and gas wells. The possibilities of dividing up interests in coal lands are so much more limited that by comparison they suggest virtually a stark simplicity. We believe that the listing that follows is for all practical purposes complete (except of course for joint heirship and partnership ownership of the particular interests to be enumerated).

One, ownership of the land in fee, which includes ownership of the surface as well as ownership of the underlying coal.

Two, ownership only of the coal underlying the land, which is thus severed from ownership of the surface.

Three, lease of the entire fee including the coal.

Four, lease of the underlying coal only, with or without an obligation to mine a stated percentage of

⁵ On occasion, as in some of the leases involved in the present case, only particular seams of coal are leased. R. 197, 200, 201, 202-203.

the coal. Such an obligation, under the law of many states, is treated as a sale of the coal in the ground.

We are not aware of any further situations.

All of the foregoing interests, very plainly, are ownership interests, in greater or less degree; they are estates in land; and if the expression "capital investment in the coal in place" has any meaning whatever, then each of the enumerated interests represents such a capital investment.

How, then, does one acquire a capital investment in the coal in place? It seems to us obvious that the only possible answer is, By acquisition of one or more of the interests enumerated above, and that such an acquisition is evidenced either by a conveyance or else by a contract to convey (which under familiar principles vests the beneficial interest in the purchaser once the contract is executed). Under that analysis, a will of course qualifies as a conveyance—as does the passage of property by intestacy, although that final variant may for most purposes be disregarded.

Accordingly, neither the buying of machinery for mining coal, nor the execution of a contract to mine coal, nor the making of expenditures preparatory to the mining of coal, can operate to transfer to the mining contractor from the owner or part owner of the coal in the ground any property interest in that coal.

Mineral rights, in whatever degree, are universally recognized as property rights, which carry the burdens of ownership, e.g. in respect of property taxes, along with the benefits that flow from ownership.

It follows that to speak of a capital investment in coal in the ground is to use an expression synonymous

and coextensive with ownership of the coal in the ground, including in "ownership" for this purpose any ownership interest whatever.

We submit that, unless words are to be used to obfuscate rather than to clarify meaning, "capital investment in the mineral in place" cannot have any meaning other than ownership of the coal in the Indeed, the words "capital investment" ground. plainly negative the notion that in seeking to ascertain entitlement to the depletion deduction, it is either appropriate or helpful to look to income, however proper that technique assuredly is in tax cases not involving depletion. E.g., Burnet v. Harmel, 287 U.S. 103: Griffiths v. Helvering, 308 U.S. 355; Helvering v. Horst, 311 U.S. 112; Commissioner v. Brown. No. 63. this Term. The reiterated criterion in the depletion cases is ownership of the wasting mineral asset, see discussion in Point IA, pp. 21-22, supra, and indeed once attention is diverted from ownership and concentrated on income the inevitable result would be the conclusion, alternatively urged on the Court by the Government in Southwest Exploration (quoted supra. pp. 41-42), that "any person who acquires the right to share in the net profits derived from the production of [a wasting mineral] has a depletable interest." That conclusion was not adopted by the Court even in Southwest Exploration, and it was decisively rejected in Parsons, which reaffirmed the importance of ownership.

We submit further that the capital investment in the coal in the ground, the ownership of the coal in the ground, can only be transferred by the means appropriate for the transfer of such a property interest.

There must be a transfer by, there must be a surrender of property interest by, the former owner—and such a transfer and/or surrender cannot be found or spelled out of other dealings by a species of magician's presto-chango.

The party who simply contracts to mine coal owned by another, regardless of expenditures made, regardless of the terms of such contract insofar as they do not purport to convey the property interest in the unmined coal, regardless of the extent of the investment made in machinery and equipment, simply does not by any combination of, or indeed all of, the foregoing acts, obtain thereby any property right, any ownership right, any capital investment, or any economic interest representing a capital investment, in the coal in the ground.

To assert the contrary involves purest fiction, and involves either recourse to the most slippery kind of sheer semanticism, or else the prestidigitation of now-you-see-it-now-you-don't, or—as in the opinion now under review—both elements.

F. In view of the controlling principle that only the owner of a capital investment in the coal in the ground is entitled to the deduction for depletion, since it is his assets alone that become exhausted in the mining process, the terms of the contracts he makes for mining the coal are meaningful only for the light they throw on the issue of ownership, and have no independent significance.

In concluding that the petitioners in Parsons v. Smith "did not actually make any capital investment in, or acquire any economic interest in, the coal in place, and that they may not fictionally be regarded as having done so" (359 U.S. at 225), the Court pointed to seven factors. All were important, and all demon-

strated the absence of any capital investment by Parsons and Huss in the coal in the ground. But those facts bore only on the ownership issue—to whom did the unmined coal belong—and it is, we submit, quite fallacious to attach independent or indeed controlling significance to particular elements.

We shall proceed to consider the enumerated factors of the Parsons and Huss contracts, as well as some others that have been emphasized in the decisions.

Fixed price for the coal. Item (6) in Parsons v. Smith, 359 U.S. at 225, "that petitioners were not to have any part of the proceeds of the sale of the coal, but, on the contrary, they were to be paid a fixed sum for each ton mined and delivered, which was, as stated in Huss, agreed to be in 'full compensation for the full performance of all work and for the furnishing of all [labor] and equipment required for the work."

Any arrangement for mining under which the contractor receives a fixed price for the coal he extracts from the ground is consistent only with the fact that the landowner or lessee owned the coal, that the landowner or lessee bore the burdens and the benefits of ownership as the case might be, and that the contractor was being paid for the labor of mining coal that belonged to another. It would indeed be a strange kind of ownership if the contractor could be insulated from fluctuations in the sale price of a product that on his assertion he owned prior to extraction. Accordingly, a good many of the early Tax Court rulings considered that a fixed price paid per ton constituted a virtually conclusive criterion for denying the contractor any deduction for depletion. E.g., Morrisdale Coal Mining Co., 19 T.C. 208; Matagorda Shell Co., 29 T.C. 1060; Nathan Fink, 29 T.C. 1119.

But, while a fixed-price arrangement in most instances barred almost automatically the contractor's claim to a share in the allowance for percentage depletion, the contrary result does not follow. Consequently, other early Tax Court rulings holding that the contractor is entitled to depletion simply because his compensation for extracting the coal is measured by a percentage of the price at which it is ultimately sold are, in our view, erroneous. E.g., James Ruston, 19 T.C. 284; Helen G. Brown, 22 T.C. 58; Virginia B. Coal Co., 25 T.C. 899; Walter Bernard McCall, 27 T.C. 133; Denise Coal Co., 29 T.C. 528. Significantly enough, the depletion part of Denise was reversed in Denise Coal Company v. Commissioner, 271 F. 2d 930 (C.A. 3), decided after Parsons, while the first McCall case was not followed once Parsons had been decided here, See Walter Bernard McCall, 37 T.C. 674, affirmed, 312 F. 2d 699 (C.A. 4). And, in Utah Alloy Ores. Inc.. 33 T.C. 917, 921, 922, where the miners received a percentage of the price paid the landowner rather than a fixed price, the Tax Court in that post-Parsons decision denied them depletion where the other facts clearly showed that the miners had made no capital investment in the mineral in place.

Where the contract is thus drawn, to compensate the contractor with a percentage of the ultimate sales price, it is true that the latter assumes the risk of the market. Many contractors do, in greater or less degree. But such a profit-sharing arrangement—or loss-sharing, as the case may be—does not supply the primary requirement reemphasized in Parsons v. Smith that the coal deposits being depleted must represent the taxpayer's capital investment as a prerequisite to his obtaining any deduction for depletion. The circum-

stance that the owner of the coal can find another party to share both his risks of loss as well as his hopes of gain does not amount to a transfer of his ownership in the unmined coal sufficient to justify a depletion allowance for the contractor who has neither made nor acquired a capital investment in the coal in the ground. (We show below, pp. 77-79, that the Tax Court's findings negative any such sharing in the present case.)

Terminability. Item (3) in Parsons v. Smith, 359 U.S. at 225, "that the contracts were completely terminable without cause on short notice."

Not only this Court but also the Third Circuit and the district court in the *Parsons* and *Huss* cases placed substantial reliance on the terminability clause in denying to these contractors any deduction for depletion. *Parsons* v. *Smith*, 255 F. 2d 595, 597-598 (C.A.3); *Huss* v. *Smith*, 255 F. 2d 599, 600-601 (C.A. 3); *Huss* v. *Smith*, 150 F. Supp. 224, 231-233, 234 (E.D. Pa.)

In a series of coal depletion cases decided by the court below, both before and after this Court's rulings in *Parsons*, so much importance was attached to the terminability of the mining contracts concerned that, in one instance, the court below brushed aside the district court's finding of fact that the oral contract was terminable, and then simply asserted the contrary without further reference to the evidence. See pp. 89 and 94-95, below.

In the present case, as we shall duly elaborate (pp. 71-76, below), the contractor had, prior to Parsons v. Smith, made oath before the Internal Revenue Service (R. 236, 244) that "The contract specified the right of termination by either party at any time, but the

question never arose between the partnership and Paragon." By the time of the trial of this case, however, the court below had read Parsons as resting primarily on the terminability of the agreements there involved. The contractors here then testified that their agreements with Paragon were nonterminable. Pp. 73-76, infra.

Our view that the right to terminate is not significant coincides with that of the Tax Court in two post-Parson cases.

In Utah Alloy Ores, Inc., 33 T.C. 917, 921, the contractors had leases for one year terms; those leases were cancellable only for cause during the year; and they were usually renewed. The Tax Court denied the contractors depletion, saying (33 T.C. at 922),

"The petitioner's [i.e., the landowner's] investment alone suffered depletion from the extraction of the ore. There is nothing in this arrangement to indicate that the miners made any capital investment in the mineral in place, which investment suffered depletion."

Similarly, in the present case the Tax Court (R. 221) said:

"While such right on the part of the landowner to terminate an agreement on short notice and without cause may far toward limiting the contractor's right to the depletion deduction, we do not think the absence of a specific right to terminate necessarily gives the contractor an economic interest in the coal in place."

For, after all, even a non-terminable contract to cut another's grass in perpetuity does not vest in the operator of the lawnmower any proprietary interest in the front yard he agrees to trim.

Mining to exhaustion. Parsons had no right to mine to exhaustion, while Huss in effect did, at least in the sense that it was only to continue until further work was deemed unprofitable. The Third Circuit relied heavily on the first circumstance in its Parsons opinion, 255 F. 2d at 597, but in Huss rested its denial of percentage depletion to the contractor on the termination clause, 255 F. 2d at 600-601. The court below in Elm Development Co. v. Commissioner, 315 F. 2d 488 (C.A. 4), attached controlling significance to the fact that the contractor there had the right to mine to exhaustion. Finally, in this case, in the teeth of a specific finding of fact by the Tax Court on sharply conflicting oral testimony that (R. 215) "The contractors were not obligated to mine any specific amount of coal and were not specifically given the right to mine any particular area to exhaustion," the court below none the less found that a right to mine to exhaustion existed (R. 255).

This Court in *Parsons* said nothing concerning the right to mine to exhaustion, an omission that confirms us in our view that this factor is quite irrelevant in considering whether the contractor is entitled to a deduction for depletion.

The terms of the contract to mine the coal, whether the arrangement is one for mining all of the underlying coal, or for an approximated portion thereof, or to extract all of the coal that can be mined in a given period of time, throw no light whatever on who has the capital investment in that coal. Before any contract to mine is made, none of the coal in the ground,

obviously, belongs to the prospective mining contractor: it belongs to the owner of the coal, whether lessee or lessor or holder of the fee. How then, does that owner divest himself of his property right in that coal? If the court below is right, he does so simply by making a more comprehensive contract for extracting his own coal. That conclusion, to speak very mildly indeed, is a palpable non sequitur. Indeed, the premise of the opinion below, that there is effected a transfer of capital investment once the owner of the coal agrees with a contractor to mine all the coal in the particular tract, plainly involves a departure from reality and from rational legal relationships to the realm of fiction and of magic, and involves as well a passage Through the Looking Glass to the unconquerable and invincible semanticism of Humpty Dumpty: "When I use a word, it means just what I choose it to mean-neither more nor less " 6

Surrender or transfer of capital investment. Item (4) in Parsons v. Smith, 359 U.S. at 225, "that the landowners did not agree to surrender and did not actually surrender to petitioners any capital interest in the coal in place."

This was the element missing in Southwest Exploration, see discussion supra, at pp. 38-40, and this is the element that is likewise missing in every reported case in which contractors who had no property right or capital investment in the coal in the ground before their mining operations started nonetheless claim an allowance for depletion deduction thereafter.

⁶ See the extensive discussion of "the profundity in Humpty Dumpty's whimsical discourse on semantics" in M. Gardner, ed., The Annotated Alice (New York, 1960) 268-270, note 6.

Indeed, if attention be carefully focused on the element of surrender (or transfer, because surrender of an interest involves its transfer to another), if every coal mining contractor claiming an allowance for depletion were sharply questioned on a single point, namely. "How and when was the lessee's capital investment in the coal in the ground ever transferred to you?," then, we submit, the contentions rejected by Parsons v. Smith but which have now been readopted by the court below, would have been finally laid to rest long since. Indeed, to press the question just framed serves to expose the utterly fictitious nature of the holding below (R. 255) that "by virtue of these contracts and their respective expenditures under them. the operators shared with Paragon an economic interest in the mineral." Significantly enough, the opinion below failed to add, no doubt because it could not, the original qualification from Palmer v. Bender. see pp. 24-25, above, that the economic interest must represent a capital investment in the unextracted mineral. Had that qualification been included, then the fiction underlying the quoted sentence would have become apparent, for then it would have read, "by virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral in place which represented their capital investment."

If that were indeed the law, then the Bumbles of the coal industry might be expected to make the usual comment. But it is not the law, for the unassailable reason that it does not state the fact:

Other indicia negativing ownership by the contractors of the coal in the ground. Items (5) and (7) in Parsons v. Smith, 359 U.S. at 225, "that the coal

at all times, even after it was mined, belonged entirely to the landowners, and that petitioners could not sell or keep any of it but were required to deliver all that they mined to the landowners"; and "that petitioners, thus, agreed to look only to the landowners for all sums to become due them under their contracts."

Both factors just cited completely negative any ownership or capital investment in the coal in the ground on the part of the contractors, because both imposed conditions on the disposition of the coal entirely inconsistent with any vestige of ownership interest therein by the contractors. For if the contractors had actually owned the coal in the ground, they would have been free to dispose of it anywhere, and hence could to that extent have looked elsewhere for their compensation.

How the coal contractors' actual and non-fictitious investments were recoverable. Items (1) and (2) in Parsons v. Smith, 359 U.S. at 225, "that petitioners' investments were in their equipment, all of which was movable"; and "that their investments in equipment were recoverable through depreciation."

There is much talk, in the opinion below as well as in other decisions antedating *Parsons* v. *Smith*, about the expenditures made by coal mining contractors, on occasion, as in the stripping cases, very heavy expenditures for acquisition of the elaborate and complex machinery that stripping requires. But whatever the nature or extent of the expenditures made by such contractors, they were all deductible under appropriate provisions of the Internal Revenue Code.

To the extent that a contractor's capital investment in either complex or simple machinery was or is being used up in the course of his mining operations, he had the right to deduct depreciation, on any one of several formulas, and thus to recover his entire investment in I.R.C. 1954, § 167. His other exsuch machinery. penditures were similarly compensable. To the extent that these other outlays could properly be treated as non-capital, they were plainly deductible as ordinary and necessary business expenses. I.R.C. 1954, § 162(a). And to the extent that his other expenditures were to be regarded as capital, they were subject not only to the deduction for depreciation, but also to capital or ordinary loss treatment with applicable carrybacks and carry-forwards if those assets were thereafter disposed of at less than their book value. I.R.C. 1954. §§ 172, 1001, 1002, 1211, 1212, 1231.

But, since the contractor did not invest any capital in the coal in the ground, the wasting mineral asset, so as to acquire any ownership interest in that coal, he did not make the particular investment that is the prerequisite to the deduction for percentage depletion. Indeed, to grant him percentage depletion in addition to the other deductions just enumerated would be not only to let him receive the benefit of an investment made by another, it would allow him a double deduction to which on any rational analysis he is clearly disentitled.

In sum, the aggregate of the seven factors enumerated in *Parsons* v. *Smith* demonstrated the insubstantiality of the contention that the contractors there had made any capital investment in the coal in the ground, that they owned any of the unmined coal. Similar techniques are bound to be helpful in other coal depletion cases, provided that the facts in those

other cases are similarly viewed, namely, to ascertain whether the contractors' claims of having made a capital investment in the unmined coal are real or fictitious. The potential pitfall lies, not in the process of undertaking the overall evaluation, but in concentrating on a particular single factor, in inflating that single factor until it is deemed to have independent significance, and, above all, in using without further analysis facile sounding expressions that have become separated from their original qualifications so that in the end the concept that they originally represented has become not only blurred but distorted.

II. LEGISLATION ENACTED AFTER THE TAX YEARS CONSIDERED IN PARSONS V. SMITH, 359 U.S. 215, AND GOVERNING THE TAX YEARS INVOLVED IN THIS CASE, LIMITS THE DEDUCTION FOR PERCENTAGE DEPLETION IN THE CASE OF COAL LEASES TO THE LESSEE ALONE, AND IN OTHER RESPECTS FURTHER EMPHASIZES THAT ONE WHO HAS SIMPLY CONTRACTED TO MINE ANOTHER'S COAL IS NOT ENTITLED TO THAT DEDUCTION.

The tax years considered in Parsons v. Smith, 359 U.S. 215, were 1945-1949 for Parsons (Fdg. 5, R. 8-9, No. 218, Oct. T. 1958) and 1944-1947 for Huss (Fdgs. 7-8, R. 29, No. 305, Oct. T. 1958). The tax years involved in the present case are 1955-1957 for Paragon (R. 15, 23, 190-191), and 1954-1956 for its contractors, respondents in No. 237 (R. 1, 6, 190). In the interim new legislation has, in three significant respects, emphasized that the coal mining contractor, the party who has simply undertaken to mine coal owned by another, is not entitled to any deduction whatever for percentage depletion.

First, the present statute specifically emphasizes ownership of the underlying mineral deposit, whereas for the tax years involved in *Parsons* v. *Smith* owner-

ship was mentioned only in the decisions and the aplicable Treasury Regulation.

Second, in the case of coal leases, the statute now grants the deduction for depletion solely and indivisibly to the lesses of the coal, whereas for the tax years involved in *Parsons* v. *Smit* that deduction was required to be equitably apportioned between the coal lessor and the coal lessee.

Third, comparison of the present provisions for capital gains treatment in respect of coal and timber shows that while Congress now defines the term "owner" to include the holder of a contract to cut timber, it does not define that word to include the holder of a contract to mine coal.

The aggregate of these statutory provisions, on which the claim of the respondents in No. 237 must stand or fall—because, after all, it is fundamental that "Whether a deduction from gross income shall be permitted for depletion of mineral deposits, or any interest therein, is entirely a matter of grace," see Parsons v. Smith, 359 U.S. 215, 219, and cases there cited in note 5—demonstrates even more clearly than was earlier possible that coal contractors have no right whatever to any deduction for depletion.

A. The emphasis in I.R.C. 1954, \$614(a), on ownership of the mineral interest negatives the right of a coal mining contractor to any depletion allowance

The present statutory scheme for depletion allowance emphasizes on its face the lack of any right thereto on the part of the coal mining contractor.

Section 613(a), I.R.C. 1954 (infra, p. 2a), states the general rule for percentage depletion as follows:

"In the case of the mines, wells, and other natural deposits listed in subsection (b), the al-

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lowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property * * *."

That is to say, the basic allowance of percentage depletion is keyed to "gross income from the property." And "property" in turn is defined by Section 614(a), I.R.C. 1954 (infra, p. 3a), in these terms:

"For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."

Hence we ask, just what "separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land" underlying Paragon's leases in this case was owned by its contractors who are respondents in No. 237? The same question can be put in the case of any coal deposit being mined under contract. In each instance, the answer must be. None. The contractors did not own any coal deposit when their operations commenced; they did not acquire ownership in any coal deposit when their contracts, written or oral, were executed; they did not acquire ownership in any coal they mined after that coal was brought to the surface; and consequently by the plain words of § 614(a) they are excluded from Congressional grace of a statutory allowance for a depletion deduction.

We think it proper to point out that, by enacting § 614(a), Congress in 1954 gave legislative sanction to

a definition of property that theretofore had been only a matter of regulation, see Treas. Reg. 111, § 29.23(m)-1(i), and of judicial decision, see the cases emphasizing ownership that we have cited and discussed above under Points IA and IB, pp. 21-27, supra.

B. Since 1951, the depletion deduction in the case of coal leases belongs indivisibly to the leases

For the tax years involved in Parsons v. Smith, the coal contractors there necessarily rested their claims on the provision for apportionment of the depletion deduction between lessor and lessee, then § 23(m), Reenacted and slightly changed in I. R. C. 1939. language as § 611(b)(1), I.R.C. 1954 (infra, p. 1a), there is still such an apportionment in respect of oil, gas, and most other minerals. But, in the case of coal since 1951 (and of domestic iron ore since 1964), the situation has been radically altered by legislation that the courts appear to have ignored, reviving in the process an attitude of "indifference, if not contempt" towards statutory enactments that Roscoe Pound decried over half a century ago. Pound, Common Law and Legislation, 21 Harv. L. Rev. 383 (April 1908).

Even since 1951, with respect to taxable years ending after December 31, 1950, the lessor of coal lands who is neither a co-adventurer, partner or principal in the actual mining of the coal has been accorded capital gains or losses treatment in respect of his royalties, and in return for that boon he is denied any allowance for percentage depletion.

This provision was first introduced by Section 325(b) of the Revenue Act of 1951 (Act of Oct. 20, 1951, c. 521, 65 Stat. 452, 501-502), amending § 117(k)(2), I.R.C. 1939; later, in 1954, in order to obviate the decision in

Island Creek Coal Co., 30 T.C. 370, sublessors of coal were included as beneficiaries, and for the years here in question (prior to its amendment by § 227 of the Revenue Act of 1964 [Act of Feb. 26, 1964, Pub.L. 88-272, 78 Stat. 19, 97] to include domestic iron ore), it read in respect of the point now pertinent, following the sentence granting capital gains treatment, as follows (Sec. 631(c), I.R.C. 1954, infra at p. 5a):

"Such-owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal."

Consequently, when Sections 611(b)(1) and 631(c) of the 1954 Code (infra, pp. 1a, 4a) are read together, as of course they must be (e.g., Duparquet Co. v. Evans, 297 U.S. 216, 218; Cardozo, J., in Panama Refining Co. v. Ryan, 293 U.S. 388, 433, 439), there is no longer any depletion deduction to be "equitably apportioned between the lessor and lessee," for the controlling reason that the lessor of coal is no longer entitled to percentage depletion. Congress amended the Code, in the face of the loss of revenue that the amendment occasioned, because the coal lessor was at a disadvantage under the percentage depletion method, even with the increase in the annual percentage in the case of coal from 5 per cent to 10 per cent that was effected by Section 319(a) of the Revenue Act of 1951 (65 Stat. at 497), amending § 114(b)(4)(A)(ii), I.R.C. 1939. See H.R. Rep. 586, pp. 31-32; Sen. Rep. 871. Part 1, pp. 42-43; Sen. Rep. 871, Part 2, pp. 43-45, all 82d Cong., 1st sess. The 10 per cent figure is now in § 613(b) (4), I.R.C. 1954 (infra, pp. 2a-3a).

The Senate Committee in 1951 was at pains to point out that the provisions for capital gains treatment in lieu of percentage depletion did not apply to a lessee. Sen. Rep. 871, Part 1, 82d Cong., 1st sess., p. 43.

It must therefore be accepted as basic that, since 1951, the lessor of coal lands has been placed on a footing wholly different, with respect to depletion allowance, from that of the lessor of oil and gas lands. It follows that the decisions in this Court, which prior to Parsons v. Smith dealt almost exclusively with the treatment to be accorded the fractionalization of leasehold interests in oil and gas, under Section 23(m) of the 1939 Code and under identical or substantially identical predecessor provisions, cannot be mechanically applied to what is now the very different situation of the depletion allowance in respect of coal.

Since, therefore, the coal lessor is no longer entitled to percentage depletion, and since there is no affirmative statutory warrant whatever for the contractor to claim depletion, there is nothing now to be apportioned, and all percentage depletion belongs indivisibly to the lessee. Accordingly, the lessee is no longer obliged to share his allowance with anyone.

The foregoing circumstances completely undercut any contention by a mere mining contractor that he is entitled to percentage depletion, a conclusion in which we are reinforced by the efforts made by the

The lessee computes his percentage depletion on his gross income from the mining property, but must, for that purpose, exclude from such gross income the amount of any rents or royalties paid in respect of the property. Section 613(a), I.R.C. 1954, infra, p. 2a (formerly § 114(b)(4)(A), I.R.C. 1939). To that extent his status as a lessee diminishes his allowable deduction for depletion. But since 1951 the lessee of coal lands need no longer divide depletion qua depletion.

present contractors to assimilate themselves to the status of lessees who participate in mining the coal.

They say (Br. Op. No. 237, p. 4) that "Paragon entered into oral leases with a number of operators," and indeed the court below made precisely the same assertion (R. 254). But, despite the unanimity with which the operators, who in 1958 had sworn to the terms of "contracts" (R. 231-246), swore in 1961 that they had "leases" (see pp. 96-97 below for record references), the Tax Court disbelieved them, and found (R. 219) that Paragon never "assigned or sublet its leases" and that its contractors "have not acquired any interest in the coal by purchase or lease from the landowners or their lessees."

In short, there is no basis whatever, either generally or else specifically on the findings in this case, for any contention that one who merely contracts with a lessee of coal lands to mine coal on the leased property can somehow bring himself within the term lessee so as to share in what since 1951 has been a depletion allowance indivisibly granted to the lessee.

It is true that the committee reports dealing with the 1951 coal amendments neither mention nor discuss the question of the coal mining contractor's right to depletion. They could not have done so, because that problem had then not yet arisen in the courts.

It was first mentioned inside the then Bureau of Internal Revenue in March 1950. See G.C.M. 26290, 1950-51 Cum. Bull. 42. The Revenue Act of 1951 was signed on October 20, 1951. The first Tax Court ruling that granted any share in the percentage depletion allowance was promulgated over a year later, on November 21, 1952. James Ruston, 19 T.C. 284. And

the first court of appeals ruling allowing the contractor any percentage depletion—and reversing the Tax Court in the process—was not published until April 9, 1954. Commissioner v. Gregory Run Coal Co., 212 F. 2d 52 (C.A. 4), certiorari denied, 348 U.S. 828.

Turning to the Internal Revenue Code, it appears that the words "economic interest" were first used there in connection with capital gains treatment for timber in 1944. See § 127(a) of the Revenue Act of 1943 (Act of Feb. 25, 1944, c. 63, 58 Stat. 21, 47), adding subsection (k)(2) to § 117, I.R.C. 1939. The same words were first applied to minerals by § 325(b) of the Revenue Act of 1951 (65 Stat. at 501), amending § 117(k)(2), I.R.C. 1939, to include coal. Plainly, then, the framers of the 1951 coal amendments could not have been expected to anticipate distortions of the economic interest concept that were not articulated until several years later.

In any event, even in the absence of the foregoing perfectly understandable explanation for the failure of any Congressional committee to discuss the coal contractors' claim to depletion in 1951, before that claim had been given serious countenance anywhere, the terms of the Code governing the present case are so clear that legislative comment thereon, serving only to repeat the obvious, is quite unnecessary. For, like Greenwood v. United States, 350 U.S. 366, 374, "this is a case for applying the canon of construction of the wag who said, when the legislative history is doubtful. go to the statute."

C. Since 1951, the distinctions made in the Internal Revenue Code between lessors, sublessors, lessees, and holders of contract rights to cut demonstrate the Congress never intended the holder of a contract right to mine coal to obtain any deduction for depletion

Finally, the restatement in the 1954 Internal Revenue Code of the 1951 coal amendments emphasizes even more strikingly the Congressional intent not to allow any percentage depletion to taxpayers who simply have contracts to mine coal.

Section 117(k)(1) of the 1939 Code, which, as has been seen, was added in 1944, became § 631(a) of the 1954 Code. Section 117(k)(2) of the 1939 Code, which was similarly added in 1944, was amended in 1951 to include coal and to deny the coal lessor depletion in return for capital gains treatment of his royalties; thereafter, in 1954, § 117(k)(2) was divided. The timber provisions became § 631(b) (infra, p. 4a), while the coal provisions became § 631(c) (infra, p. 4a). (In 1964, the latter subsection was expanded to include domestic iron ore as well as coal, see p. 5a, infra.)

These subsections, § 631(b) and § 631(c), reveal significant differences. The last sentence of the timber subsection, Section 631(b), states:

"For the purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber."

But the coal subsection, Section 631(c), provided prior to the 1964 amendments that "the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor."

These distinctions, which are inherently important, become even more striking when read in the light of the indisputable fact that while coal deposits, like other minerals, are subject to percentage depletion, timber resources are not, and never were. Sec. 631(b), I.R.C. 1954; §§ 114(b)(3) and (4), I.R.C. 1939.

That is to say, while Congress now defines the term "owner" to include the holder of a contract to cut timber, it does not define that word to include the holder of a contract to mine coal. For timber, which is not subject to percentage depletion, it is sufficient to own "an interest in such timber"; for coal, which is subject to percentage depletion, it is necessary to own "an economic interest in coal in place."

It is true that the timber subsection, § 631(b) of the 1954 Code, does not and did not logically belong under and with other provisions dealing with depletion, since it dealt only with capital treatment of income; but the difference in language in successive subsections, § 631 (b) concerning timber and § 631(c) dealing with coal, cannot be ignored, and it is moreover significant that when the latter section was amended in 1964 to include domestic iron ore along with coal, Congress retained the earlier language so as to make the amended section repeat the necessity of owning "an economic interest in coal or iron ore in place" (infra at p. 6a)—and did not include the holder of a contract to mine coal or iron ore in its definition of "owner."

In our view, therefore, the expression in force for the tax years here in question, "economic interest in coal in place"—which, interestingly enough, was only the third time that the words "economic interest" had ever appeared in the internal revenue laws, the first being in 1944, in connection with timber, and the second in 1951, relating to both timber and coal—the quoted expression plainly involves an incorporation of the "economic interest" concept in the limited and restricted sense that it was first expounded by the Court in Palmer v. Bender and Bankline Oil, in the limited and restricted sense that from Bankline it was copied into and still remains in the Treasury Regulations, and in the limited and restricted sense that it was restated and reaffirmed in Parsons v. Smith.

It follows that, when the 1954 Code is read with regard to its terms rather than in the light of preconceived notions drawn from other provisions, the conclusion is inescapable that Congress never intended to grant even a share of the allowance for percentage depletion to a taxpayer who had only a contract to mine coal in which he had no ownership or other capital investment.

We hope that the Court will not deem the foregoing treatment of the depletion provisions of the current Internal Revenue Code to be either labored or unduly long. But we felt bound to cover the matter in detail, for, as the opinion under review (R. 252-255) indicates, the court below undertook to adjudicate rights to a statutory deduction without once citing, much less discussing or even quoting, the statutory provisions on which that deduction rested. And, in the process, it allowed the deduction for percentage depletion to a coal contractor, who is not only not named in the Code as the beneficiary of such a deduction, but is by the clearest kind of statutory implication denied any right whatever thereto.

- III. THE DECISION UNDER REVIEW, WHICH ALLOWED DEDUCTION FOR PERCENTAGE DEPLETION TO PARTIES WHO SIMPLY CONTRACTED TO MINE PARAGON'S COAL. REACHED ITS RESULT THROUGH THE APPLICATION OF SEMANTICIZED FICTIONS THAT DISREGARDED PARSONS V. SMITH, 350 U.S. 215, AND DISREGARDED AS WELL THE APPLICABLE PROVISIONS OF THE INTERNAL REVENUE CODE AND OF THE REGULATIONS THEREUNDER.
- A. The decision under review disregarded Parsons v. Smith and this Court's emphasis there and in other cases on ownership representing a capital investment in the mineral in the ground as the criterion of entitlement to the deduction for depletion.

As we have said, Parsons v. Smith, 359 U.S. 215, 220, unanimously reaffirmed the proposition that "the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset." Accord, United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 86: "Depletion * * is an allowance for the exhaustion of capital assets."

Here, as in Parsons (359 U.S. at 224), the mining contractors "do not show or suggest that [they] actually made any capital investment in the coal in place. or that the landowners were to or actually did in any way surrender to [the contractors] any part of their capital interest in the coal in place. [The contractors] do not factually assert otherwise. Their claim to the contrary is based wholly upon an asserted legal fiction. As stated, they claim that their contractual right to mine coal from the designated lands and the use of their equipment, organization and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place." But while this Court in Parsons decided that (p. 225) "that fiction cannot be indulged here." the court below revived it, with the result that,

to use the Commissioner's language (Mem. Op. 3), "the decision of the court of appeals is basically in conflict with *Parsons*."

We think that, without in any sense even summarizing the extended discussion in Point I (supra, pp. 20-58), we can best document what the Commissioner characterized as "the clear error of the decision below" (Mem. Op. 3) by quoting in order the several factors listed in Parsons (359 U.S. at 225) as negativing the fictitious assertion made by the contractors there, and then showing how many of those factors were likewise present here only to be disregarded by the court below.

1. The contractors' investments were in their equipment, all of which was movable—not in the coal in place. In the present case also, the mining contractors provided their own mining equipment (R. 213-214), on occasion acquiring it from predecessor contractors (R. 212). Contractors who quit took their equipment with them unless it was subject to a lien (R. 215). The contractors' investment was in their equipment, roads, and buildings (R. 216). They acquired no legal title to the coal in place (R. 216, 222), nor did they acquire any interest in the coal by purchase or lease from the landowners or their lessees (R. 219). They paid nothing for the coal (R. 221, 222), and indeed most of the contractors "disclaim any capital investment in the coal in place—the unmined coal" (R. 222).

Plainly, therefore, uone of Paragon's contractors made any capital investment in the coal in place—the factor that under Parsons v. Smith and the earlier cases here on which Parsons rested is the prime requisite for entitlement to the deduction for percentage depletion.

2. The contractors' investments in equipment were recoverable through depreciation-not Paragon's contractors invested only in equipment, roads, and buildings; see references just cited. took and claimed tax depreciation on their equipment and other assets (R. 212), all of which the Tax Court accordingly characterized as "depreciable equipment" (R. 221, 224).

Thus Paragon's contractors are in process of recovering their entire capital investment. Consequently, to allow these contractors a deduction for depletion in addition to their deduction for depreciation, as the court below did, would be to let them recover in addition for the exhaustion of a further capital investment that they never made.

3. The contracts were completely terminable without cause on short notice. While, for reasons set forth at greater length above, pp. 51-53, we believe that a nonterminable contract to mine coal belonging to another does not and can not of its own force transfer to the contractor any capital interest in that coal while it is still in the ground, we are confident that an objective view of the record here will show that Paragon's contracts with its mining contractors were, in fact and in law both, terminable by either party at any time; and that the Tax Court's failure so to find was a consequence of that tribunal's not attaching the proper legal significance to sworn written admissions binding all the respondents in No. 237, which clearly established the mutual terminability of the contracts.

First. Although the Tax Court found (R. 215, 220-221) that nothing was said about the right to terminate when the agreements were made, it pointed out (R. 223-224) that "Paragon could not give an absolute

nonterminable right to mine to exhaustion in view of the landowner's reserved rights under the Paragon lease to terminate in the event of noncompliance with the terms of the lease." Accordingly, it went on to say (R. 224) that "While we cannot find that the right to terminate was specifically mentioned when the agreements were made, neither can we conclude that the agreements were nonterminable."

Passing the point that in the absence of a conclusion that an agreement was nonterminable it was, necessarily, terminable, we are prepared to demonstrate that, even though the question of the terminability or otherwise of Paragon's oral contracts was the most sharply contested testimonial issue at the trial in the Tax Court, that tribunal's conclusions on the terminability issue are, insofar as they represent findings of fact, clearly erroneous—because they disregarded sworn written statements executed a year and a half before the Tax Court proceeding were filed.

Second. Since, under § 7482(a), I.R.C. 1954, decisions of the Tax Court are reviewable on the same footing as non-jury cases tried in United States District Courts, see Commissioner v. Duberstein, 363 U.S. 278, 291, the applicable standard here is the "clearly erroneous" test of Rule 52(a), F. R. Civ. P., with its authoritative gloss (United States v. United States Gypsum Co., 333 U.S. 364, 395) that "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Judged by that standard, the Tax Court was mistaken, particularly since its finding on the present issue rested on an inadequate evidentiary concept.

Third. In Exhs. 86 and 87, G. Wesley Merritt, one of the respondents in No. 237, twice stated under oath (R. 236, 244) that

"The contract specified the right of termination by either party at any time, but the question has never arisen between the partners and Paragon."

It is true that both documents were offered and admitted for purposes of impeachment only (R. 161). But this reflected too limited a view of their evidentiary force. Both documents were independently probative as admissions, not simply because they were presented to the Commissioner's subordinates in this very matter of the depletion claims of the partners constituting Kyva and Standard Smokeless, but primarily because they were sworn to by one who was a party to the petition brought against the Commissioner in the Tax Court. 4 Wigmore, Evidence (3d ed. 1940) § 1048. Both exhibits were therefore independently admissible for all purposes—once their authenticity was established, and we do not understand that to be questionedand they would have been thus admissible even if the affiant had never been adduced as a witness by either side.

Moreover, since G. Wesley Merritt was a member of both partnerships, Kyva and Standard Smokeless, and was acting within the scope of his authority for the benefit of both, viz., seeking to reduce their respective tax liabilities, his admission binds all of his partners. 4 Wigmore, supra, § 1078, esp. at p. 126. Those partners include all of the respondents in No. 237.

G. Wesley Merritt made oath to both Exh. 86 and Exh. 87 on May 19, 1958 (R. 237-238, 245-246). The several petitions of the respondents in No. 237 were

filed in the Tax Court on November 23, 1959 (R. 1 for Docket No. 84122; see unprinted record for Dockets No. 84123-84126). The several mining contractors' testimony that the question of termination was never discussed (R. Lee Merritt, R. 140; G. Wesley Merritt, R. 147; Watson, R. 170, 172) was not given until November 14, 1961.

We submit that the ante motam litem affidavits filed with the Internal Revenue Service in this very matter are so clearly more credible than the oral testimony to the contrary given three and a half years later, after the cause was being actively litigated, that the Tax Court's finding, which is based on the latter, must be regarded as "clearly erroneous"—particularly since that Court's view that the affidavits had only impeaching value cannot be supported.

Fourth. The transition in G. Wesley Merritt's sworn assertions regarding terminability reflects a transition in the decisional law laid down by the court below.

- (i) In May 1957, in Stilwell v. United States, 152 F. Supp. 111 (W.D. Va.), the district court found that "The contract entered into between plaintiffs and Paragon was terminable at the will of either party" (Fdg. 14, 152 F. Supp. at 113). The court below, disregarding that finding, said in December 1957 that the contract was not terminable. Stilwell v. United States, 250 F. 2d 736, 739 (C.A. 4).
 - (ii) Exhibits 86 and 87 were executed in May 1958 (R. 237-238, 245-246).
 - (iii) In April 1959, this Court in Parsons v. Smith, 359 U.S. 215, 225, in the course of dispelling the fiction that one who mines coal under contract and invests in

mining machinery somehow acquires thereby a depletable capital interest in the coal in the ground, enumerated seven factors, of which terminability was only one.

- (iv) But in December 1959, when the court below proceeded to apply the *Parsons* doctrine for the first time, in *United States* v. *Stallard*, 273 F. 2d 847 (C.A. 4), it rested its decision on the single factor of terminability to the virtual exclusion of all else, and that decision has been so interpreted since. See *infra*, pp. 90-94, and especially *Elm Development Company* v. *Commissioner*, 315 F. 2d 488, 490-491.
- (v) G. Wesley Merritt testified in the Tax Court on November 14, 1961 (R. 146; Tr. 914, 1042).8

The foregoing chronology illuminates the conversion of G. Wesley Merritt.

When, in May 1958, he set forth the terms of his and his partners' contracts with Paragon in detail (R. 235-236, 243-244), and made oath (R. 236, 244) that "The contract specified the right of termination by either party at any time, but the question has never arisen between the partners and Paragon," he swore truthfully. That was before terminability had assumed its later significance in the decisional law. But when, in November 1961, he testified that termination was never discussed, he was plainly endeavoring to swear up to the headnote in *United States* v. Stallard, 273 F. 2d 847 (C.A. 4), decided in December 1959. His subsequent efforts to "explain" the earlier affidavits, see R. 156-161, simply reflect the classic symptoms of a wit-

^{8&}quot;Tr." refers to the unprinted transcript of testimony in the Tax Court, the pages of which are indicated by "fol." in the printed record here.

ness who has been impaled on a disremembered docu-

Accordingly, on the whole record, it is plain that, if the matter is material as a matter of law, G. Wesley Merritt and his partners had contracts with Paragon that were terminable by either party at any time.

Fifth. The record shows that many of Paragon's contractors quit at will (R. 212, 213, 215, 223), a finding consistent only with G. Wesley Merritt's earlier sworn statements on behalf of himself and the other respondents in No. 237 (R. 236, 244) that the contracts were mutually terminable at any time.

Since, therefore, the contractors could quit, i.e. terminate, at will, so could Paragon, for as a matter of State law, it is plain that if a contract is at the will of one party, it is at the will of both. Cowan v. Radford Iron Co., 83 Va. 547, 551, 3 S.E. 120, 122; Eason v. Rose, 183 Va. 359, 364-365, 32 S.E. 2d 66, 68-69; Shorter v. Shelton, 183 Va. 819, 824, 33 S.E. 2d 643, 645-646; 1 Minor, The Law of Real Property (Ribble's 2d ed. 1928) § 357. We think it plain that, whatever the Federal tax consequences, the operation and construction of the contracts here cannot be governed otherwise than by resort to State law, here the law of Virginia, and we fail to grasp the relevancy of the Oklahoma diversity case resting on estoppel that was relied on by the court below (R. 255) in its effort to negative mutuality here. Phillips Petroleum Company v. Buster, 241 F. 2d 178 (C.A. 10), certiorari denied, 355 U.S. 816. Neither do we perceive the relevancy of the other decision cited below (R. 255), a South Carolina diversity case turning on actionable libel and on what aspects of an action for damages arising out of a terminated contract of employment should have been submitted to the jury. Jack's Cookie Company v. Brooks, 227 F. 2d 935 (C.A. 4), certiorari denied, 351 U.S. 908.

4. Paragon as lessee did not agree to surrender and did not actually surrender to the mining contractors any capital interest in the coal in place. Court found (R. 211) that "Paragon acquired by assignment written leases on the coal in and underlying the land here involved in Buchanan County, Virginia. which leases required the lessee to mine either all or 85 per cent of the minable coal in and underlying the tracts under lease": that (R. 211) "Paragon assumed all the obligations of the lessees under the leases, and was obligated to pay annual minimum royalties, and land taxes"; that (R. 214) "The contractor did not assume any of Paragon's obligations under its leases and paid no royalties or taxes on the property or the mineral interest"; that (R. 216, 222) the contractors acquired no legal title to the coal in place; that (R. 219) they acquired no interest in the coal by purchase or lease from the landowners or their lessees; that (R. 221, 222) the contractors paid nothing for the coal; that (R. 222) most of the contractors "disclaim any capital investment in the coal in place—the unmined coal"; and that (R. 222) "Paragon did not intend to nor did it actually surrender any capital interest in the coal in place to the contractors."

Not only is the last quoted finding on lack of surrender fatal to the contractors' contentions as a matter of Federal law, but the totality of the findings just summarized has significant consequences as a matter of State law.

(i) Under Virginia law (Va. Code § 58-774, infra, p. 7a), when the ownership of the surface and of the

underlying coal are divided, the tax authorities are required to ascertain "the estate of each and the relative fair market value of their respective interests." Yet here the only taxes on the coal in the ground were paid by Paragon and not by its contractors (R. 211, 214).

(ii) As a matter both of state and general law (13 Michie's Jurisprudence of Virginia and West Virginia 25-26 [Mines and Minerals, § 14]; Bankers Pochahontas Coal Co., v. Central Pochahontas Coal Co., 113 W. Va. 1, 166 S.E. 491; see Browning v. Boswell, 215 Fed. 826, 835 (C.A. 4), semble), leases such as Paragon held the required it "to mine either all or 85 percent of the minable coal in and underlying the tracts under lease" (R. 211), constituted an actual sale to Paragon of the coal in the ground.

That is to say, Paragon as a matter of State law had all (or at the very least a most substantial portion) of the property in the coal in the ground, and duly paid real estate taxes on that property, while the contractors as a matter of State law had no property interest in the coal in the ground and by their conduct of not paying taxes on that coal disclaimed ownership therein. Of course those circumstances are not conclusive; it is far too late in the day to urge that Federal taxation is governed by State doctrines of property; but when parties such as the present contractors in effect represent to the State that they do not own sufficient property interests in unmined coal to be liable for real estate taxes thereon under a State statute that requires the ascertainment of "the estate of each and the relative fair market value of their respective interests" in "the coal * * * under the surface" (Va. Code, § 58-774, infra, p. 7a), while simultaneously representing to the United States that they have a sufficient property based on "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land" (§ 614(a), I.R.C. 1954, infra, p. 3a) to be permitted to deduct from their Federal taxes for depletion of that property; one may, at the very least, raise both eyebrows and make searching inquiry as to how or when they obtained their asserted property interest.

Here, as before (supra, pp. 69-70), the contractors' asserted property interest in the unmined coal is purely fictitious: No capital assets belonging to the contractors were in any way exhausted or even impaired in the course of the mining process.

5. The coal at all times, even after it was mined, belonged entirely to Paragon, and the mining contractors could not sell or keep any of it, but were required to deliver to Paragon all that they mined. The Tax Court's findings show that all of the coal extracted from Paragon's leased lands by its mining contractors was required to be delivered by them to Paragon exclusively (R. 213, 216, 221-222). Specifically, the Tax Court found (R. 216) that "The contractors sold none of the coal to anyone other than Paragon and were not entitled to do so," and that (R. 216, 222.) "They acquired no legal title " " to the coal after it was mined."

All of these factors, plainly, are inconsistent with any surrender of capital interest from Paragon to its independent mining contractors by virtue of their mining contracts.

6. The contractors were not to have any part of the proceeds of the sale of the coal, but, on the contrary,

they were to be paid a fixed sum for each ton mined and delivered. Here, also, the Tax Court's findings in this case show that (R. 214, 222) the mining contractors were compensated by Paragon for mining its coal at a fixed price, which was determined in advance and not subject to retroactive change, and which was earned when the coal was delivered to Paragon's tipple; and, moreover, that the mining contractors were notified in advance of all price changes, and that these took effect prospectively, so that each contractor knew at all times what he would receive for every ton mined, though not what he might receive for coal as yet unmined. Accordingly, it was Paragon and not the contractors who took the risk of market changes occurring after mining.

As the Tax Court said (R. 222), "the contractors had no interest in the coal legally or otherwise after they had delivered it to Paragon. They were paid a fixed price per ton delivered and had no knowledge or interest in the price that Paragon received from the sale of the coal to the consumer. While there is some evidence that the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs, there is no evidence that the amount paid by Paragon was directly related either to the price it was getting for the coal or to the sales price of a particular contractor's coal, and the amount was apparently changeable at the will of Paragon."

Again, these facts require the conclusion that it was Paragon rather than the contractors who had every bit of properly interest in the capital assets that were being depleted by the mining operations. 7. The contractors thus agreed to look only to Paragon for all sums to become due them under their contracts. This final factor from the listing in Parsons is also present here, as the Tax Court's finding shows (R. 216):

"The contractors completed their obligations under the contracts by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay them so much per ton. The contractors were not concerned with the sales price Paragon received for the coal."

The Tax Court further said, following the passage quoted under the previous heading, that (R. 222) "It is also undisputed that the contractor knew the fixed sum he would receive before he delivered the coal. In other words, the contractor had to rely on the personal covenant of Paragon for payment for his services rendered in producing the coal."

Here also, the very specific findings that have been quoted negative any vestige of capital investment in the unmined coal on the part of the contractors.

The foregoing discussion completes the enumeration of the seven factors canvassed in *Parsons* v. *Smith*, 359 U.S. at 225. In the present case there is a further factor, pointing in the same direction as all of the others, namely, the detailed control that Paragon exercised over its contractors' mining operations. To that we turn:

8. Paragon's rigid control over the actual mining operations is consistent only with its ownership of the coal in the ground, and is utterly inconsistent with the notion that the contractors had any property interest whatever in such unmined coal. The Tax Court found (R. 214-215) that Paragon selected an engineer, who was paid by the mining contractors, and who then on Paragon's behalf directed them in detail how and where to mine, and as to what pillars they could or could not remove. It found further (R. 215-216, 222-223) that the changes that were thus directed in the course of the mining operations were not predictable in advance, and that this made it impossible to assign to any contractor at the outset any specific area that he could mine to exhaustion.

If the mining contractors had actually owned any capital interest in the coal in the ground, it is inconceivable that they would have submitted to such restraints in dealing with what on their legal theory was their own property—even though, with questionable regard to consistency, they disclaimed any capital investment in the unmined coal (R. 222). But the answer to this speculation, very plainly, is that none of the contractors had, in fact or in law, any property interest in the unmined coal in the ground; and so the Tax Court found and held (R. 216, 221-222).

Indeed, all of the factors discussed above (other than that of terminability) demonstrate such a complete bundle of property rights by way of capital investment in the coal in the ground on Paragon's part, and such a complete lack of any property interest whatever in the unmined coal on the part of the contractors, as to lead independently to the conclusion that the mining contractors' rights were subject to termination by

Paragon at the latter's election, and this quite apart from the sworn admissions in Exhs. 86 and 87 that the contracts when made so provided in terms.

By way of summary, then, as this Court said in Parsons, 359 U.S. at 225,

"Surely these facts show that petitioners did not actually make any capital investment in, or acquire any economic interest in, the coal in place, and that they may not fictionally be regarded as having done so."

But the court below, relying on the circumstance (R. 254-255) that "The parties contemplated that the operators would, and the evidence shows that they did, engage in large expenditures of time and money in preparing their respective sites for mining," concluded (R. 255) that "By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of Parsons v. Smith, 359 U.S. 215 * * *."

That is to say, the court below paid only lip service to Parsons v. Smith, and in its own decision revived the precise fiction that this Court there advisedly refused to indulge. Or, to use the Commissioner's language (Mem. Op. 3), "the decision of the court of appeals is basically in conflict with Parsons," which "presented the same issue on substantially similar facts" (Mem. Op. 2).

B. The decision under review likewise disregarded the provisions of the 1954 Internal Revenue Code and of the regulations thereunder that demonstrate in unmistakable terms the lack of entitlement to any deduction for depletion on the part of persons who contract to mine another's coal.

There is no need even to summarize here the detailed demonstration already made in Point II, supra, pp. 56-58, that under the provisions of the Internal Revenue Code of 1954 there is not even a vestige of statutory language affirmatively granting any part of the depletion allowance to a taxpaper who has simply made a contract to mine coal belonging to another, and that indeed those provisions by the clearest kind of statutory implication negative any such grant.

Yet, as we have said, the court below held Paragon's contractors entitled to share in the depletion allowance without even citing a single statutory provision (R. 252-255), an omission the more striking since every deduction is under established principles a matter of legislative grace (e.g., Parsons v. Smith, 359 U.S. 215, 219, and cases cited in note 5), an omission peculiarly remarkable in this case since the capital gains treatment for coal contained in § 631(c), I.R.C. 1954, on which Paragon's argument and brief below relied in such large measure, was reflected in well over half of the Tax Court's opinion, which dealt with the royalty issue—as to which no review was sought by either party—under that very subsection (R. 189 (headnote 1), 193-211).

Similarly, the court below disregarded the applicable regulation, § 1.611-1(b)(1) (infra, p. 7a), which provided, in language drawn from Helvering v. Bankline Oil Co., 303 U.S. 362, 367, 368, that "a person who has no capital investment in the mineral deposit * * * does not possess an economic interest merely because

through a contractual relation he posses a mere economic or pecuniary advantage derived from production."

We are not similarly critical in respect of the failure to refer to § 1.611-1(c)(2) of the regulations, infra, p. 8a, invoked by the contractors (Br. Op., No. 237, p. 1f), which deals with "the case of a lease or other contract providing for the sharing of economic interests in a mineral deposit." That regulation is completely irrelevant here, inasmuch as the Tax Court's findings negative any lease to the several mining contractors, whether by Paragon or anyone else (R. 219), and similarly show (R. 222) that "Paragon did not intend to nor did it actually surrender any capital interest in the coal in place to the contractors."

In short, neither the asserted "leases" nor the actual contracts provided "for the sharing of economic interests in a mineral deposit." Accordingly, there is no need to dwell on the further circumstance that the contractors have no property within the other provision of this regulation, that the deduction for depletion "shall be computed by each taxpayer by reference to the adjusted basis of his property * * *."

C. The decision under review marks a reversion to rulings of the court below antedating Parsons v. Smith that permitted one without any capital investment whatever in the coal in the ground to obtain the benefit of the deduction for depletion none the less.

A series of coal depletion cases in the court below that antedated Parsons v. Smith, 359 U.S. 215, formulated a concept of depletion quite at variance with what this Court held in Parsons. But because those decisions were not specifically disapproved by the Parsons opinion, the court below apparently felt free to

recur to their approach, see Elm Development Company v. Commissioner, 315 F. 2d 488, 490 (C.A. 4), with the result that, in the decision now under review, the Parsons rationale was completely abandoned. Accordingly, it will probably be helpful to review the Fourth Circuit's course of decision in coal depletion cases.

The first such ruling was Commissioner v. Gregory Run Coal Co., 212 F. 2d 52 (C.A. 4), certiorari denied, 348 U.S. 828, where depletion was first granted to a coal contractor, and where the basic concept of the allowance for mineral depletion was altered. Even the question was stated in terms that reflected the deviation (212 F. 2d at 55):

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"The question involved is whether the taxpayer, who mined the coal under the contracts herein described, as distinguished from the taxpayer, who held the leases on the coal land, had such an economic interest in the operation as to entitle it to take the deduction for depletion allowed by the federal statutes."

We have added the italics to emphasize the departure from the requirement, restated in Parsons, but going back to Palmer v. Bender, 287 U.S. 551, 557, and Helvering v. Bankline Oil Co., 303 U.S. 362, 366-368, that there must be an economic interest, not in the operation, but in the mineral in the ground which represents a capital investment.

None the less, on the strength of what was said in Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, the court below in Gregory Run then allowed the contractor depletion, concluding (212 F. 2d at 61) that "in the pending case the rights of the producers were com-

pletely dependent upon the extraction of the salable product and that consequently they were entitled to share in the benefits of the statute which were designed to give compensation to persons interested in the production of a wasting asset."

To the contrary, as this Court has several times said (Helvering v. Bankline Oil Co., 303 U.S. 362, 367; Parsons v. Smith, 359 U.S. 215, 222), "the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit."

The court below again allowed a coal contractor to deduct for depletion in Weirton Ice & Coal Supply Co. v. Commissioner, 231 F. 2d 531 (C.A. 4), in an opinion that emphasized the misconceptions on which that result was rested.

Thus, at p. 534 it said, "It is well established that the purpose of the depletion allowance provisions of the statute was to encourage the explorations of natural resurces which are exhausted upon recovery * ." It seems a sufficient reply to point out that this Court has found a different purpose (Parsons v. Smith, 359 U.S. 215, 220):

"The purpose of the deduction for depletion is plain and has been many times declared by this Court. 'It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production.' " " " [The depletion] exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired."

In the Weirton case the Court below also said (231 F. 2d at 535): "No stronger proof that Weirton had in effect the right to mine the coal could be found than in its willingness to invest \$500,000 in the enterprise." But it is only taxpayers investing in a mineral deposit who are granted a depletion allowance; investment in "the enterprise" is insufficient. Parsons had an investment of well over \$200,000 in his machinery (Fdg. 31, R. 21-22, No. 218, Oct. T. 1958), Huss had around \$500,000 worth of equipment on the job (Fdg. 21, R. 32, No. 305, Oct. T. 1958), yet neither was held entitled to any deduction for depletion.

In the next depletion case decided by the court below, Commissioner v. Hamilt Coal Corp., 239 F. 2d 347 (C.A. 4), the same question arose in another context. There the taxpayer was the lessee, and the question was whether its depletion allowance was to be shared with its contractor, Daniel Coal Company. The taxpayer-lessee built the tipple, designated the areas to be mined, paid the contractor an agreed rate for the coal mined regardless of the market price for coal, and mined additional coal by itself after terminating its contract with Daniel. The court below, following its earlier decisions, held that the contractor in those circumstances was entitled to share in the depletion allowance.

Fallacies identical with those previously exposed underlay the result. E.g. (239 F: 2d at 350), "These observations [as to the details of the arrangement] are pertinent but when the whole case is considered they do not justify the conclusion that Daniel had no economic interest in the enterprise as that phrase has been interpreted by the Courts." (Our italics.) E.g. (239 F. 2d at 350-351), "In our opinion these condi-

tions created an economic interest in the mineral in place not only in the taxpayer but also in Daniel, both of whom made a substantial investment and took a substantial risk dependent upon the successful sale of the coal." Without repeating, we simply ask, "Substantial investment in what?"

In Stillwell v. United States, 250 F. 2d 736 (C.A. 4), the court below allowed depletion to one who mined under contract with Paragon, petitioner in the present case, in disregard of specific findings of fact that the centract was terminable at will, and that the contractor bore no risk of fluctuating market prices. Pp. 94-95, infra. (One of the appellants there testified as a witness in this case (R. 128) that they never bought any interest in the coal in place.) Both facts found by the district court negatived, in our view, any capital investment on the part of the Stilwells in the unmined coal, however much their contract with Paragon conferred upon them an economic advantage.

It was at that juncture that the *Parsons* and *Huss* cases came here from the Third Circuit; certiorari was sought in both on the footing of conflict with the foregoing line of decision by the Fourth, and the briefs of both sets of petitioners on the merits cited and argued the same Fourth Circuit decisions.

As we have repeatedly indicated, both the reasoning and the result of those decisions were necessarily disapproved by the opinion of this Court in *Parsons* v.

conflict with the decisions of the Court of Appeals below is squarely in conflict with the decisions of the Court of Appeals for the Fourth Circuit' (Pet. 9, Parsons v. Smith, No. 218, Oct. T. 1958); "The decision of the Court of Appeals is in conflict with the decisions of the Court of Appeals for the Fourth Circuit' (Pet. 10, Parsons v. Huss, No. 305, Oct. T. 1958).

Smith, 359 U.S. 215. But the Parsons opinion did not specifically disapprove those decisions by name, in consequence of which their reasoning has been resurrected, reaching full flowering in the ruling now under review. Accordingly, the depletion cases decided in the court below since Parsons v. Smith need to be briefly reviewed.

(i) In United States v. Stallard, 273 F. 2d 847 (C.A. 4), the court below did indeed deny depletion to tax-payers who had mined coal under contracts. But in reaching that decision, the court reduced the seven factors set out in Parsons, 359 U.S. at 225 (see supra, pp. 48-49) to essentially, the single factor of terminability, saying (273 F. 2d at 852-853):

"We find no material difference between the circumstances of the Parsons case and those of the case at bar. In both, the claim to a deduction rested upon the contract between the taxpayer and the owner under which the taxpayer agreed to furnish the equipment and mine and deliver the coal to the owner at a fixed price per ton; and the right of the taxpayers to carry on the operation was completely subject to the will of the owner by reason of the right of the owner to cancel the contract at any time without cause on short notice. In view of the similarity of these essentials, the minor differences in the facts of the two cases do not distinguish them in the application of the statute."

(ii) We say, "the single factor of terminability," because the Stallard decision was so read by the Tax Court in Walter Bernard McCall, 37 T.C. 674, a ruling that came before the court below in McCall v. Commissioner, 312 F. 2d 699 (C.A. 4). There depletion was also denied to coal contractors, again with heavy re-

liance on the terminability clause in their contracts (pp. 701, 704, 705, 706), although there was much discussion of the issue whether the taxpayer's earlier preParsons victory in the Tax Court, Walter Bernard
McCall, 27 T.C. 133, operated as a collateral estoppel
in his favor. In holding that it did not, the court
below reasserted the significance of terminability (312
F. 2d at 706):

"With this review, there can be little question but that the Parsons decision, supra, and the Stallard decision, supra, constituted a marked shift in emphasis, if not in basic law, by the Supreme Court and this Court, respectively, of the circumstances where a depletion deduction could be lawfully claimed. That the earlier Tax Court decision, McCall v. Commissioner, 27 T.C. 133 (1956); as compared to the one appealed here, 37 T.C. 674 (1962), represented a similar shift is equally clear. In the earlier case, the formal findings of fact include mention of the thirty day cancellation clause, but the opinion may be read in vain to find any discussion of the significance of this fact.' In the latter, squarely in reliance on Parsons v. Smith, supra, the terminable nature of Rebecca's interest"-Rebecca Coal Company was a contractor-"was held decisive."

(iii) In Elm Development Company v. Commissioner, 315 F./2d 488 (C.A. 4), terms of the mining

^{• [}Footnote in original] "To the contrary, the opinion rested on a different basis, 27 T.C. 133, 136;

[&]quot;Among the most important criteria in determining whether an independent contractor possesses a true economic interest or only an economic advantage in the coal which he mines are whether or not he has an exclusive right to mine all of the coal within a given area and whether he must look to a sale thereof for his profit—the price which he receives being dependent upon the market price of the coal when sold."

contract plainly negatived any ownership of the coal by the contractor at any time; they read in pertinent part (R. 9a in that case, quoted from C.I.R. Br. 13-14):

"Title to all coal mined and delivered by the Contractor shall at all times, from the time of its severance until its sale by the Company, remain in the Company and Contractor shall have no interest in the coal or in any proceeds from the sale thereof.

"All obligations of the Company to make payments to Contractor hereunder shall be obligations owed by the Company to be paid out of its funds or assets and Contractor shall have no lien or charge against any of the coal produced by it or against the proceeds from the sale thereof."

The Commissioner accordingly argued (C.I.R. Br. 9-35) that "The Tax Court correctly concluded that Elm Development Company had no investment interest in the coal in place on Lorado's leasehold." But the court below allowed depletion to the contractor none the less, on the ground that the contract was terminable only for its default or lack of profitability to the lessee, concluding (315 F. 2d at 491) that when the contract is not terminable at will or on short notice, "the mining company has been granted a right in the coal in place; that is, the right to mine till exhaustion."

The court below also said (315 F. 2d at 490-491), "We distinguish the instant case from Parsons, Stallard and McCall on the ground of terminability. " * * "

[The mining company's] right to mine the coal without risk of cancellation is its economic interest in the coal in place. The owner has given up an interest in the coal, his right to mine it himself or to determine whether it is mined and who is to mine it. Where the contract is terminable at will or on short notice the

These excerpts quite fail to explain either (a) how a nonterminable contract to mine could, in the face of the provisions of that centract quoted above, transfer the lessee's capital investment in the coal in the ground to its mining contractor, or (b) how a nonterminable contract in the terms of that one operates as a surrender of capital interest while a terminable one does not. We submit that no such explanations are available, or can be formulated—unless of course fiction is to be deemed an acceptable substitute for legal reasoning.

- (iv) The present case, Merritt v. Commissioner, 330 F. 2d 161 (C.A. 4), is of course diametrically opposed to everything ruled in Parsons v. Smith, as the detailed documentation under Point IIIA, supra, pp. 69-83, demonstrates.
- (v) Finally in Cooper v. Commissioner, 330 F. 2d 163 (C.A. 4), pending on petition for a writ of certiorari, No. 262, this Term, which was decided simultaneously with and on the authority of the present case, the Tax Court had found as a fact on conflicting evidence that the contractors "have failed to establish by a preponderance of evidence that their rights were not subject to termination by Jewell Ridge [the lessee]." Raymond E. Cooper, 39 T.C. 253, 256-257. But the court below none the less reversed, weighed the mass of conflicting evidence on that issue independently, and held that the contractors were entitled to a deduction for depletion.

Or, by way of capsule summary of the Fourth Circuit's post-Parsons decisions on coal depletion, that

court has yet to indicate its ungrudging acceptance of the principles expounded in Parsons v. Smith.

D. The decision under review ignored findings of fact made by the Tax Court, many of them on sharply conflicting evidence.

The course of decision by the court below in coal depletion cases discloses a consistent disregard of findings made by the trier of facts.

- reversing 152 F. Supp. 111 (W.D. Va.), where the court below held that certain of the present petitioner's contractors were entitled to share in Paragon's depletion allowance, is one of its earliest decisions that attached controlling significance to terminability (250 F. 2d at 739): "A most important factor is the terminability of the taxpayer's rights." But while stressing that factor, the court below brushed aside, without further review of the evidence, the findings of fact made by the district court. This appears from the following extracts:
 - (A) Finding 14, 152 F. Supp. at 113:
- "14. The contract entered into between plaintiffs and Paragon was terminable at the will of either party."

(A) C.A. 4 opinion, 250 F. 2d at 739:

"The contract was not terminable by Paragon as long as taxpayers' operations were satisfactory and the coal could be profitably marketed. ••• This is not a case where the contract is clearly terminable at the will of either party ••• "

(B) Finding 16, 152 F. Supp. at 113:

"16. Plaintiffs completed their obligation under the contract by delivering the coal to Paragon's tipple and thereupon became entitled to their compensation for mining the coal by virtue of Paragon's personal covenant to pay for such services at the amount per ton previously agreed upon by the contracting parties. Plaintiffs were not concerned with the sale price Paragon received for the coal."

(B) C.A. 4 opinion, 250 F. 2d 739:

"This is not a case " " where the contractor's income is dependent upon the personal covenants of those with whom he has contracted without regard to the price at which the coal is sold."

When the court below said here (R. 255, note 2) that "the Stilwell case arose out of the same facts," it did not indicate whether it relied on the facts that the district court found there or on the "facts" that the court of appeals invented there.

(2) In the companion case to the present one, Cooper v. Commissioner, 330 F. 2d 163 (C.A. 4), pending on petition for a writ of certiorari, No. 262, this Term, the Tax Court specifically found (Raymond E. Cooper, 39 T. C. 253, 256-257) that "petitioners have urged that their agreements with Jewell Ridge [the lessee] were not subject to termination on the part of Jewell Ridge. Much evidence, both direct and indirect, was given at the trial of this case which bore upon this question. After considering the evidence, we conclude that the petitioners have failed to establish by a preponderance of the evidence that their rights were not subject to termination by Jewell Ridge."

But the court below had no difficulty in brushing aside that finding in the *Cooper* case in the light of its holding in the present case. It said (330 F. 2d at 164):

"We have concluded; therefore, that upon this record as a whole the court was clearly in error in finding that the petitioners had no economic interest in the coal in place and that their contracts were terminable at will by Jewell Ridge. We see nothing to be gained by a detailed repetition of the facts and the reasons underlying our decision in that case."

- (3) In the present case, the court below brushed aside the Tax Court's findings on three significant issues.
- (a) Contract or lease? (i) The Tax Court's opinion throughout makes it plain to any objective and disinterested reader that (R. 211-212) Paragon "contracted the mining out to various individuals and firms who were to mine the coal at their own expense." The Tax Court spoke of "agreement," "agreements," "contract," and "contracts" at least fifteen times (R. 211-216, 219, 221), and referred to the several respondents in No. 237 as "contractors" or "contractor" no less than 70 times by actual count in the course of its discussion (R. 213-216, 219, 221-224).

The Tax Court specifically noted (R. 219) that Paragon never "assigned or sublet its leases" and further stated (R. 219) that "The contractors here have not acquired any interest in the coal by purchase or lease from the landowners or their lessees * * *."

(ii) But, in the face of those explicit findings, the court below asserted (R. 254) that "Paragon entered into oral leases with a number of operators"! (We have added the italics out of sheer amazement.)

The court of appeals' disregard of the Tax Court's findings in this instance is the more inexcusable since the contractors and their witnesses at the trial consistently used the word "lease" in virtually an organby their counsel, or else on their own (R. 110, 115, 118, 121, 124, 126, 132; 133, 134, 141, 151, 165, 168, 174, 176, 183, 184, 186). Significantly, one of the contractors who talked about a "lease" admitted that he neither paid for the lease nor paid any rent or royalty thereunder (R. 141); while G. Wesley Merritt, another contractor who talked "lease" (R. 151, 165) had, some years earlier, sworn to documents submitted to the Internal Revenue Service in which he consistently referred, on behalf of all his partners (who together with him constitute the respondents in No. 237), to their agreement with Paragon as a contract and never once called it a lease (R. 231-246).

In other words, the Tax Court, which observed the several contractor-witnesses, disbelieved their conclusory characterization of the arrangements with Paragon. But the court below, notwithstanding, said (R. 254) that "Paragon entered into oral leases with a number of operators."

(b) Fixed price. Here is the departure by the court below from the findings made by the trier of facts:

Tax Court (R. 222).

C.A. 4 (R. 254, 255)

"While there is some evidence that the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs, there is no evidence that the amount paid by Paragon was directly related either to the price it was getting for the coal or to the sales price of a particular contractor's coal, and the amount was apparently changeable at the will of Paragon."

"Paragon agreed to pay a fixed price at the tipple, but it was understood that the price would, and in fact it did, vary with the market. " the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price."

Whether the restatement effected by the court below was designed to bring the present case more nearly into line with the early pre-Parsons Tax Court rulings holding that contracts under which the miner was paid a percentage of the ultimate sales price almost automatically entitled him to the depletion allowance (supra, pp. 50-51) would of course be only speculation. But the circumstance that the court below in reversing the Tax Court took such obvious liberties with its findings is not speculation at all, but a demonstrable fact.

(e) Mining to exhaustion. (i) In its opinion, the Tax Court detailed how Paragon's engineer directed the contractors' mining, so that one contractor did not break through into the mine of an adjacent contractor, but would be able to pierce the barrier if the adjacent contractor ceased operating (R. 214-216). It found (R. 215) that "The contractors were not obligated to mine any specific amount of coal and were not specifically given the right to mine any particular area to exhaustion."

Later in its opinion the Tax Court amplified the evidence underlying the quoted finding. It said (R. 222-223):

"The evidence rather indicates that the contractors were given a general area in which to mine under the supervision of an engineer who was authorized to plan a system of mining for the extraction of all the minable coal in the seam and who was authorized to change the projection of any contractor's mine in order to accomplish this objective. * * * we believe the barriers were shown primarily to prevent adjacent contractors from breaking through into each other's mines and were not intended to specify definite boun-

daries for the areas of coal the contractor was entitled to mine. * * * it could not be determined in advance from just what direction the coal in an area would have to be mined to recover all minable and merchantable coal. But inasmuch as Paragon was obligated under its leases to remove at least 85 percent of the coal, the areas given to a particular contractor had to be and remain flexible."

The Tax Court then continued (R. 223-224):

"The evidence is conflicting as to whether the contractors were given the right to mine a specific area of coal to exhaustion. However, there is very little conflict in the evidence that the contractors were not obligated to mine any boundary of coal to exhaustion, and in fact, many of them quit at any time they chose. It seems unlikely that the parties would have contemplated granting the contractor the nonterminable right to mine specific areas to exhaustion without also obligating him so to mine it. Furthermore, Paragon could not give an absolute nonterminable right to mine to exhaustion in view of the landowner's reserved rights under the Paragon lease to terminate in the event of noncompliance with the terms of the lease. While we cannot find that the right to terminate was specifically mentioned when the agreements were made, neither can we conclude that the agreements were nonterminable."

(ii) The court below brushed aside these findings also. It said (R. 255), "We think the Tax Court was in error in concluding that because the oral contracts were silent on the point, the operators did not possess a non-terminable right to mine to exhaustion, especially in the fact of the court's finding of an intent on the part of the parties to the contrary. "The fact that the contracts did not fix upon the operators an obliga-

tion to mine to exhaustion does not vitiate the binding effect of the intent of the parties to vest in the operators a right to mine to exhaustion."

We only ask, In what specific tract, described either by metes and bounds or by natural features, did any particular contractor have such a right when he commenced work? That palpably unanswerable question, we submit, underscores the liberties taken by the court below with the findings made by the trier of facts.

E. The decision under review rests its result on a series of semanticised fictions.

We had supposed that *Parsons* v. *Smith*, 359 U.S. 215, marked the shift from fiction to reality in coal depletion cases. But, in this aspect also, its teaching is not reflected in the decision under review; the opinion below, in no less than three respects, relies on semantic devices.

1. "Paragon's experience was as a processor and seller of coal rather than a producer; furthermore it lacked the capital to go into the producing end of the business" (R. 253). "* * the operators had a continuing right to produce the coal * * *" (R. 255).

The verb "produce" is pure semantics—or, perhaps more precisely, impure semantics, because that word is demonstrably inaccurate both in fact and in law.

The word "produce" is wrong in fact, because the several contractors simply mined the coal. They did not produce it and Paragon could not produce it. The coal was produced by geologic forces over the centuries.

The word "produce" is doubly wrong as a matter of law.

Paragon was engaged in mining, and it did not cease to be a coal mining concern simply because the persons actually extracting its coal were independent contractors rather than its direct employees. Qui fecit per alium fecit per se.

Moreover, under the explicit provisions of I.R.C. § 613(c)(2), as it stood for the tax years here in question (infra, p. 3a), "mining" was defined as including "not merely the extraction of the eres or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product." And "ordinary treatment processes" in the case of coal was further defined in I.R.C. § 613(c)(4)(A), again for the tax years concerned here (infra, p. 3a), as including "cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment."

Under the Tax Court's findings concerning Paragon's functions (R. 212, 216), therefore, Paragon was a coal mining company. both in law and in fact. It follows that to speak of "producing" coal, and to contrast "producer" with "processor" to Paragon's disadvantage, as the court below did, is to inject an element of verbal obfuscation that inhibits meaningful legal analysis.

2. "Paragon entered into oral leases with a number of operators" (R. 254).

^{107&#}x27;Paragon would then clean and size the coal and sell it on the market" (R. 212). "The coal as delivered to Paragon's tipple by the contractors was not in a state which was salable to the consumer but had to be washed, graded, and treated in order to be salable upon the consumer market. All such processing was done by Paragon at its processing plant." (R. 216.)

We have already dealt with the use of the word "lease" by the court below, in disregard of the findings of fact; see pp. 96-97, above. This is actually less an instance of semantics, a device that involves subtle numbers of meaning than of downright mislabeling, reminiscent of Tom Sawyer's insistence as a matter of principle that the pickax he was finally compelled to use was a case-knife nonetheless. See Pound, The Spirit of the Common Law (1921) 166-167.

Wide latitude, of course, is allowed the trier of facts in drawing evidentiary inferences that cannot be stated in absolute terms where determinative features can only be found in "intent"; the classic recent example was the Government's proposal to promulgate principles and presumptions to govern what was and what was not a "gift" for Federal tax purposes. Commissioner v. Duberstein, 363 U.S. 278; United States v. Kaiser, 363 U.S. 299.

No such latitude, we believe, is available where the point in question is susceptible to more objective evalulation, as here on the issue of contract versus lease. But, to the extent that the trier of facts has any freedom in the present situation, the Tax Court's findings (R. 219) that Paragon's mining contractors received no lease from it or from any other source, whether by sublease or by assignment, are unassailable. Those findings are not "clearly erroneous" on any theory, and hence are safe in this Court from the inverted verbalism with which the court below (R. 254) spoke of "oral leases."

3. "The parties contemplated that the operators would, and the evidence shows that they did, engage in large expenditures of time and money in pre-

paring their respective sites for mining. *** By virtue of these contracts and their respective expenditures under them, the operators shared with Paragon an economic interest in the mineral which brings them within the rationale of *Parsons* v. *Smith*, 359 U.S. 215 * * *." (R. 254-255.)

Actually, these key passages from the opinion below simply repeat the very semantic device that was scotched by *Parsons*, because they omit the significant qualifications emphasized there, qualifications that the court below prior to *Parsons* had consistently disregarded (pp. 85-89, *supra*).

Parsons, 359 U.S. at 224, disposed of the "asserted legal fiction" that a "contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place."

Parsons emphasized throughout that the requisite economic interest must represent a capital investment in the coal in the ground, and was at pains to point out that the party asserting such an investment must show a surrender to it of the capital interest in such coal.

In short, the court below brushed aside both the holding and the reasoning of *Parsons* v. *Smith*, and, by resort to the precise semantic fiction that was there expressly and indeed emphatically rejected, has by a species of sleight of hand transformed expenditures under a mining contract into a capital investment in the unmined coal. Therein lies the basic fallacy of the decision under review.

CONCLUSION

The decision below nullifies Parsons v. Smith, 359 U.S. 215. The judgment below should therefore be reversed, with directions to reinstate the decision of the Tax Court.

Respectfully submitted.

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APPENDIX

STATUTES AND REGULATIONS INVOLVED

1. Sections 611(a) and (b), I.R.C. 1954, as amended, are as follows:

"§ 611. Allowance of deduction for depletion

"(a) General rule.—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term 'mines' includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613 (c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such. prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

"(b) Special rules.—

- "(1) Leases.—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.
- (2) Life tenant and remainderman.—In the case of property held by one person for life with remainder to another person, the deduction under this section shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.

"(3)" Property held in trust.—In the case of property held in trust, the deduction under this section shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

- "(4) Property held by estate.—In the case of an estate, the deduction under this section shall be apportioned between the estate and the heirs, legates, and devisees on the basis of the income of the estate allocable to each."
- 2. Section 613(a), I.R.C. 1954, as amended through 1960, provided as follows:

"§ 613. Percentage depletion

- "(a) General rule.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section."
- 3. Section 613(b)(4), I.R.C. 1954, provides as follows:
 - "(b) Percentage depletion rates.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

- "(4) 10 percent—asbestos (if paragraph (2) (B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite."
- 4. Sections 613(c)(2) and 613(c)(4)(A), I.R.C. 1954, provided, prior to the 1960 amendments, as follows:
 - "(c) Definition of gross income from property.—
 For purposes of this section—
 - "(2) Mining.—The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.
 - "(4) Ordinary treatment processes.—The term 'ordinary treatment' processes' includes the following:
 - "(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treatment to prevent freezing, and loading for shipment; * * *"
 - 5. Section 614(a), I.R.C. 1954, provides as follows:
 "6 614. Definition of property
 - "(a) General rule.—For the purpose of computing the depletion allowance in the case of mines,

wells, and other natural deposits, the term 'property' means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land,"

- 6. Section 631(b), I.R.C. 1954, provides as follows:

 "5 631. Gain or loss in the case of timber or coal
 - "(b) Disposal of timber with a retained economic interest.—In the case of the disposal of timber held for more than 6 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. The date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term 'owner' means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.
- 7. Section 631(c), I.R.C. 1954, provided prior to the 1964 amendments as follows:
 - "(c) Disposal of coal with a retained economic interest.—In the case of the disposal of coal (in-

cluding lignite), held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal, and the word 'owner' means any person who owns an economic interest in coal in place, including a sublessor. The date of disposal of such coal shall be deemed to be the date such coal is mined. In determing the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545 (b) (5))."

8. Section 631(c), I.R.C. 1954, following its amendment by § 227 of the Revenue Act of 1964, provides as follows:

"§ 631. Gain or loss in the case of timber, coal, or domestic iron ore

[&]quot;(c) Disposal of coal or domestic iron ore with a retained economic interest.—In the case of the dis-

posal of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss. as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word 'owner' means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron In determining the gross income, ore is mined. the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545 (b)(5)). This subsection shall not apply to any disposal of iron ore-

[&]quot;(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or

- "(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore."
- 9. The third paragraph of Section 58-774 of the Code of Virginia provides as follows:

"If the surface of the land is held by one person and the coal, iron and other minerals, mineral waters, gas or oil under the surface be held by another person, the estate of each and the relative fair market value of their respective interests shall be ascertained by the commissioner [of revenue of the respective county]."

10. Sections 1.611-1(b)(1) and 1.611-1(c)(2) of the Regulations under I.R.C. 1954 provide as follows:

"NATURAL RESOURCES

"DEDUCTIONS

"§ 1.611-1 Allowance of deduction for depletion

"(b) Economic interest.—(1) Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber. An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the extraction of the mineral or severance of the timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because through a contractual relation he possess a mere economic or pecuniary advantage derived from production.

For example, an agreement between the owner of an economic interest and another entitling the latter to purchase or process the product upon production or entitling the latter to compensation for extraction or cutting does not convey a depletable economic interest. Further, depletion deductions with respect to an economic interest of a corporation are allowed to the corporation and not to its shareholders."

"(c) Special rales

"(2) Leases.—In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee. In the case of a lease or other contract providing for the sharing of economic interests in a mineral deposit or standing timber, such deduction shall be computed by each taxpayer by reference to the adjusted basis of his property determined in accordance with sections 611 and 612, or computed in accordance with section 613, if applicable, and the regulations thereunder."

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for certiorari was filed on June 1, 1964, and was granted on October 12, 1964 (R. 257). In No. 237, the time for petitioning for a writ of certiorari was extended by order of the Chief Justice to July 15, 1964 (R. 257); the petition was filed on July 1, 1964; and certiorari was granted on October 26, 1964 (R. 258). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether contract miners of coal who have no legally enforceable right to receive anything more than the value of their services for delivering coal to the lessee of mineral rights have a depletable capital interest in the mineral deposit.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 611. ALLOWANCE OF DEDUCTION FOR DE-

- (a) General Rule.—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under gulations prescribed by the Secretary or his delegate. * * *
 - (b) Special Rules .-
- (1) Leases.—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

SEC. 613. PERCENTAGE DEPLETION.

(a) General Rule.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. * * *

(b) Percentage Depletion Rates.—The mines, wells, and other natural deposits, and the percentages referred to in subsection (a) are as

follows:

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucité, coal, lignite, perlite, sodium chloride, and wollastonite.

(c) Definition of Gross Income from Property.—For purposes of this section—

(1) Gross income from the property.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

Sec. 614. DEFINITIONS OF PROPERTY.

(a) General Rule.—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

STATEMENT

These cases involve deficiencies in income tax for the years 1954-57 asserted by the Commissioner of Internal Revenue against Paragon Jewel Coal Company, the lessee of coal bearing lands, and against the contract miners who extracted the coal on those lands. The deficiency in each case arose from the denial of a claimed percentage depletion deduction. The parties agree that either Paragon or the contract miners-but not both-are entitled to the contested percentage depletion deduction. The Commissioner's position, here as in the court below, is that Paragon (petitioner in No. 134) is entitled to the deduction and that the contract miners (respondents in No. 237) are not. The two cases were consolidated in the courts below and have been consolidated here by order of the Court (R. 258).

1. The contract miners ' were members of partnerships which entered into oral agreements with the lessee of coal lands to mine the coal and deliver it to the lessee's tipple.' A representative of Paragon and the prospective miner would choose a location on the out-

¹ The respondents' wives are parties in No. 237 only because they filed joint income tax returns with their husbands. (R. 192–193.)

² Paragon was actually a sub-lessee or assignee of the leases (R. 211), a fact with no significance here. Its written leases on Virginia coal tracts required it to mine at least 85 percent of the merchantable coal in the tracts and to pay minimum annual royalties, tonnage royalties, and land taxes. The contract miners did not assume any of Paragon's obligations under its leases and they paid no royalties or taxes on the property or the mineral interest. (R. 213-214.)

crop and the representative would indicate, on a map or on the surface of the ground, the general area and direction in which the contract miner could mine. At his own expense and with his own men and equipment, the miner would mine the coal by driving entries into the hill-from a point on the outcrop, bring the severed coal to the surface, load it on trucks, and deliver it to Paragon's tipple. Paragon then cleaned and sized the coal and sold it on the open market. (R. 193–205, 211–212.)

The contract miners were obligated to deliver any coal they mined to Paragon; they could not take it elsewhere. Paragon set and changed at will the amount it offered to pay the miners for each ton of coal mined and delivered. The contract miners were normally given several days notice of any change in the price that would be paid for coal delivered at Paragon's tipple. In fact, Paragon changed the price on some nine occasions in a six-year period encompassing the taxable years involved here. Paragon made those changes either to induce the miners to continue to mine when it appeared that they were unable to make a profit, to keep step with union wage increases paid by Paragon's competitors, or when Paragon's profit margin diminished as a result of a general downward trend in prices. The contract miners had no interest in the proceeds of the sale of the coal. Their right to payment did not depend upon the existence of sales proceeds and the amount of payment did not vary with the daily fluctuation in. the market prices of coal. (R. 95-96, 119-120, 169, 186, 214, 216, 230.)

The agreements were not for a definite term. On the contrary, the contract miners were free to quit at any time if they found they could not mine profitably, and a number did cease mining from time to The agreements did not obligate the contract miners to mine a specific area of coal to exhaustion, nor were they specifically given a right to mine any particular area to exhaustion. However, it was anticipated by both parties that a contract miner would continue mining in the location assigned to him as long as he could mine coal profitably and as long as he employed proper mining methods in extracting the merchantable coal. Several of the respondents paid other contract miners to be permitted to succeed them in the operation of existing mines. In one instance, \$3,500 was paid, added to depreciable assets and written off over a two-year period. In another instance, \$21,000 was paid for equipment and mining rights, allocated to equipment, and depreciated. (R. 173, 212-213.)

2. Paragon claimed percentage depletion based on the amounts it received for selling the coal in the open market (less royalties paid to lessors and sublessors). (R. 192, 216-217.) Some of the contract miners claimed percentage depletion based on the amounts they received from Paragon for mining and delivering the coal. (R. 217.) The Commissioner of Internal Revenue determined that the contract miners, through their partnerships, were not entitled to any percentage depletion deduction. In order to protect

the revenue should the miners prevail, he also determined that Paragon was required to diminish its percentage depletion base in each year by the amount it paid to the contract miners. (R. 217.) Deficiencies were determined accordingly. (R. 5-11, 22-28, 192, 216-217.)

The Tax Court held that Paragon, and not the contract miners, was entitled to the contested portion of the depletion deduction (R. 217-225) because the contract miners "made no investment in and equired no economic interest in the coal in place" (R. 224). In reaching that result it found that the contractors "acquired no legal title either to the coal in place or to the coal after it was mined." They "sold none of the coal to anyone other than Paragon and were not entitled to do so." Paragon "paid the contractors the prices fixed by Paragon" (R. 216), and the amount so paid "was apparently changeable at the will of Paragon" (R. 222).

On review, the court of appeals reversed (R. 252–255). Overturning a finding of the Tax Court that the oral contracts were terminable at will by Paragon, the Fourth Circuit found that "the operator had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price" (R. 255). This, the court held, resulted in a depletable economic interest in the minerals.

ARGUMENT

PARAGON, AND NOT THE CONTRACT MINERS, IS ENTITLED TO THE PERCENTAGE DEPLETION DEDUCTION, FOR THE CONTRACT MINERS DID NOT HAVE A CAPITAL OR ECONOMIC INTEREST IN THE UNMINED MINERAL DEPOSIT

Introduction

In the case of coal, Sections 611 and 613 of the Internal Revenue Code of 1954 authorize a percentage depletion deduction in an amount equal to 10 percent of the "gross income from mining." duction is intended to allow a taxpayer to recover the capital value of a mineral in place which is diminished by extraction and sale of the mineral. This is accomplished by treating a statutorily prescribed percentage of the proceeds of sale of the mineral as a return of the taxpayer's capital interest in the unmined deposit. While there may be more than one depletable interest in the same deposit, the total amount of the depletion deduction is a constant, a specified part of the "gross income from mining" the deposit. Accordingly, the deduction must be parcelled among whichever taxpayers have a depletable interest in the deposit.

The present case involves conflicting claims of taxpayers competing for a portion of the percentage depletion allowance arising from the sale of coal extracted by contract miners from a lessee's mineral leases. Specifically, the question is whether the lessee of the coal lands is entitled to percentage depletion on all the gross income derived from the sale of the coal mined from the leases, or whether the contract miners who do the mining acquired a depletable interest to the extent they were paid by the lessee for mining and delivering coal to it. We believe it plain, on the facts of this case, that Paragon, the lessee, is entitled to the contested depletion allowance because it owned a valuable but wasting interest in the mineral deposit and the miners did not.

"The purpose of the deduction for depletion is plain and has been many times declared by this Court. 'It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production.' Helvering v. Bankline Oil Co., 303 U.S. 362, 366," Parsons v. Smith, 359 U.S. 215, 220. Accordingly, the deduction is available only to the owner of a capital interest in the mineral deposit. Burton-Sutton Oil Company v. Commissioner, 328 U.S. 25. The legal form of such a capital interest is unimportant; it is sufficient if the taxpayer owns what this Court has called an "economic interest" so long as this ownership interest constitutes a capital asset, a right with regard to the mineral in place, which is depleted as the deposit is mined and sold. Burnet v. Harmel, 287 U.S. 103; Palmer v. Bender, 287 U.S. 551. But at a minimum, the taxpayer must have a legally enforceable right to share in the value of the unmined mineral deposit, whether by receipt of part of the mineral itself or by sharing in the proceeds of its sale. Palmer v. Bender, 287 U.S. 551. Without such a right, the taxpayer has no capital

interest in the deposit which could be exhausted by production and sale of the mineral.

A contract miner has no capital interest in a mineral deposit-i.e., no enforceable right to share in the value of that deposit-if his right to payment for delivering the coal he mines is subject either to the leesee's power to terminate the contract at will or to the lessee's power to pay the miner only the value of the services he actually performs. In the first case, the contract miner has no capital interest in the coal, for he can be cut off from any payments whatsoever at the will of the lessee. That is obviously inconsistent with the existence of a legally enforceable right in the deposit itself. The second case is equally clear. If the lessee can reduce the . price the contract miner will be paid for mining and delivering the coal to the value of the miner's services with the miner's only recourse being to withdraw from the job, the miner has no legally enforceable right to share in any value of the unmined mineral deposit. He can demand payment only for the value of his services, for if he refuses to work unless paid more, the lessee can substitute another contractor to perform the services.

It is plain, on the facts of this case, that Paragon, the lessee, had and exercised the right to set and reset the price the contract miners were paid for mining the coal and was at most obligated to pay only the value of the services actually rendered. The miners, therefore, had no legally enforceable right to share in the value of the mineral deposit and, thus,

no capital interest in that deposit which was exhausted with the mining and sale of coal.

I

ONLY A TAXPAYER WITH A LEGALLY ENFORCEABLE RIGHT TO SHARE
IN THE VALUE OF A MINERAL DEPOSIT HAS A DEPLETABLE CAPITAL OR ECONOMIC INTEREST IN THAT DEPOSIT

Section 611 of the Internal Revenue Code of 1954 directs that a reasonable allowance for depletion shall be made "[i]n the case of mines * * * according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations to be prescribed by the Secretary"; and that "[i]n the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee." Section 613 provides that the allowance for coal shall be 10 percent "of the gross income from [mining] the property [during the taxable year] excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxable respect of the property".

The percentage depletion deduction is intended to allow tax-free recovery of the capital value of a mineral deposit by deducting from gross income that part of the proceeds of sale of the mineral which Congress has determined represents the value of the wasting asset in the ground. Since, as this Court has repeatedly recognized, the deduction is meant to recognize

³ Section 613(c)(1) provides that the "term 'gross income from the property' means, in the case of a property other than an oil and gas well, the gross income from mining."

for tax purposes the loss of capital to a taxpayer as he progressively mines and sells a wasting asset, the deduction is premised on the existence of a capital interest owned by the taxpayer in the mineral depositan interest which diminishes in value as a result of the deposit's exhaustion through extraction and sale of The depletion "exclusion is designed to the mineral. permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." Commissioner v. Southwest Exploration Co., 350 U.S. 308, 312. See, also, Parsons v. Smith, 359 U.S. 215, 220; United States v. Ludey, 274 U.S. 295, 302; Anderson v. Helvering, 310 U.S. 404, 408; Kirby Petroleum Co. v. Commissioner, 326 U.S.:599, 603.

Because the statute deals with economic realities, not legal forms, a taxpayer need not have any particular form of legal title to the mineral deposit to be entitled to share in the depletion deduction. But he must have, at a minimum, a legally enforceable right to share in the value of the mineral deposit, either by sharing in the mineral itself or in the realization of its value by sale. For if he has no such legally enforceable right, the taxpayer has no capital or economic interest in the deposit which is reduced in value by the extraction and sale of the mineral. Since the percentage depletion deduction is granted to compensate for the reduction in value of a taxpayer's capital assets caused by mining a mineral deposit, it is available only to a taxpayer who has an enforceable right to share in the value of the deposit and thus whose capital assets are reduced by mining.

A CONTRACT MINER HAS NO LEGALLY ENFORCEABLE RIGHT TO SHARE IN THE VALUE OF A MINERAL DEPOSIT IF EITHER (1) THE AMOUNT HE IS TO BE PAID CAN BE REDUCED AT THE WILL OF THE LESSEE TO THE VALUE OF THE MINING SERVICES OR (2) THE CONTRACTOR'S RIGHT TO MINE CAN BE TERMINATED AT WILL BY THE LESSEE

1. A contract miner who is required to deliver the mined coal to the lessee at whatever price the lessee chooses to post from time to time obviously has no capital or economic interest in the value of the mineral deposit even though he has a right to continue to mine the deposit so long as he is willing to do so at the posted prices. Being legally free to set the tipple price at whatever level it chooses, the lessee need pay the miner only whatever amount is necessary to induce the miner to continue to mine and may thus keep for itself the whole value of the mineral deposit in place. Whether the value of the deposit be small or great, the miner receives only what he is able to command for his services and it is the lessee, and the lessee alone, who realizes upon the value of the mineral in place.

It is true, of course, that economic forces will constrain the lessee's exercise of his legal freedom to set the tipple price: if it wishes to stay in business, the lessee must pay the miners enough to keep them working. If business is bad, the miners may be willing to accept less in order to keep their jobs. If business is good, they will ask for more and—depending on their economic bargaining power or the lessee's "enlightenment"—may be able to get it. Economic forces

will thus cause the tipple price to move, not only with wage rates in the area, but also, at least to a degree, with the market price of coal. The forces producing that result, however, are no different from those entering into the determination of wages in any industry. The fact that increased profits in the automobile industry enhance the bargaining position of the employees and may enable them to obtain a wage increase does not give automobile workers a depreciable interest in their employer's equipment. No more does the fact that economic forces may cause a coal lessee to increase the tipple price when the market price for coal increases give contract miners a depletable interest in the coal deposit. All the miners have to sell is their services, and what they receive is only what, under the economic conditions existing from time to time, they are able to command for those services. The costs of extraction-i.e., what the lessee must pay the miners to induce them to continue mining-will of course affect the value of the deposit in the ground, but, whatever that value is, it will redound to the benefit only of the lessee. The contract miners have no greater or different right to share in the value of the deposit than do the office personnel employed by the lessee, who likewise may be able to demand higher salaries when business is good.

The fact that a contract miner has no legal interest in the mineral in place does not, of course, mean that he suffers no loss when the mineral is exhausted. When the deposit is exhausted, he will be out of a job, and it may be that he will be unable to find another as advantageous. But that loss is no different from that of a lawyer when a client dies or that of an employee when the plant burns down. The loss is merely from the termination of an advantageous business relationship, not the exhaustion of a capital interest in the mineral deposit itself. The reason, again, is that the contract miner is entitled to receive only what he can command for his services. Whatever the owner of a mineral deposit is able to command by virtue of his ownership accrues only to the lessee, and it is only the latter who has a right to share in the value of the mineral in place.

2. We have thus far considered the case in which. while the contract miner is entitled to continue to mine. the deposit so long as he wishes to do so, the lessee is free of any legal restraints in setting or changing the tipple price. The result would be no different, however, if the lessee were legally bound to pay the contract miners the reasonable value of their services in the light of the labor and market conditions existing from time to time—an agreement which might, for example, provide for arbitration should the parties be unable to agree. Such a right would merely substitute legal remedies for economic bargaining power to determine the amount to be paid the miners for their services. So long as the standard by which the tipple price is to be determined is the value of the miners' services in mining the coal-with the market price of coal being relevant only to the extent that ability to pay is normally relevant to wage determinations—the substitution only makes explicit what is implicit in relying on economic forces to determine the tipple price: that the contract miners, furnishing only services, have a right (or power) to demand only what their services are worth. The miners would still have no right to share in the value of the mineral deposit. The lessee need offer them only the value of their services, and if the contract miners refuse to mine at the offered price, the lessee may substitute other contractors to do the mining, thus still retaining for itself the full value of the unmined mineral deposit. Under such a contract, in short, the contract miner has only a right to be paid the fair value of his services, not a right to share in the value of the mineral in place, and the capital interest in the mineral deposit—and the benefit of any increase in its value or in the ultimate sale price of the coal—is retained in full by the lessee.

3. Similarly, a contract miner has no capital or economic interest in the value of a mineral deposit, whatever the price terms, if the lessee has the power to terminate the contract at will. It is, of course, a commonplace that one does not own what can be taken a way by another with impunity. That is no less true of mineral deposits than of other assets. A mining contractor does not have a capital or economic interest in unmined coal if he has no right to demand part of the value of that deposit, and he has no enforceable right to share in its value if the lessee is entitled to terminate the miner's interest whenever the miner is demanding or receiving more than the value of his mining services. In short, a contract

miner whose contract is terminable at the will of the lessee has no asset of any value in respect of the mineral deposit, for he has no power to tap the resource without the continuing consent of the lessee.

Ш

THE CONTRACT MINERS IN THIS CASE HAD NO CAPITAL OR ECONOMIC INTEREST IN THE UNMINED COAL BECAUSE PARAGON COULD, AT ANY TIME, REDUCE THE PRICE PAID FOR DELIVERY OF MINED COAL TO THE VALUE OF THE MINERS' SERVICES ALONE

We have shown that the existence of a power in the lessee either to terminate the contract at will or to reduce the amount paid for delivering coal to the value of the miner's services precludes any contention that a contract miner has a depletable capital interest in the mineral deposit in place. We believe it is unnecessary to analyze the oral contracts in this case to determine whether they were terminable at the will of Paragon as the Tax Court held, for the fact that Paragon at all times retained the right to reduce the amount paid the miners to the value of their services is plain on the record and the findings of the Tax Court and is uncontradicted by the court below.

1. The Tax Court found that the contractors had no right to dispose of coal they had mined. They could deliver only to Paragon at prices set by Paragon. Their bargaining power arose solely from their right to refuse to furnish the necessary mining services. Thus, the contractors "acquired no legal title either to the coal in place or to the coal after it was mined" (R. 216). They "sold none of the coal to any-

one other than Paragon and were not entitled to do so" (R. 216). "If Paragon was unable to take all of the contractors' coal * * * the Contractor would fill his own bins and then shut down until Paragon could take more of his coal" (R. 216). "During the years here involved. Paragon took all merchantable coal produced by the various contractors operating on Paragon's leased property and paid the contractors the price fixed by Paragon" (R. 216). "While there is some evidence that the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs, there is no evidence that the amount paid by Paragon was directly related either to the price it was getting for the coal or to the sales price of a particular contractor's coal, and the amount was apparently changeable at the will of Paragon" (R. 222).

The record evidence that Paragon had the power to set the price the miners would receive for any and all coal they mined is overwhelming and, unlike the evidence as to terminability, wholly uncontradicted. See R. 56, 86, 87, 90-91, 93, 105, 119, 141-144, 185-186; see also R. 49-50, 64-65, 114, 136, 147, 170, 180. There is absolutely no indication that the miners had legally enforceable rights to receive any other amount than that set and reset by Paragon prospectively to induce the performance of mining services. While the Fourth Circuit correctly noted that "it was understood that the price would, and in fact it did, vary with the market" (R. 254), the record makes it entirely clear that the understanding was primarily a warning to

the miners that their price for mining would have to fall if the market price of coal fell and secondarily an unenforceable assurance by Paragon that, like any forward-looking businessman, it would treat its contractors generously if times improved. Neither the warning nor the assurance casts any doubt on the correctness of the Tax Court's findings that the price paid the miners was "fixed by Paragon" (R. 216) and "was apparently changeable at the will of Paragon" (R. 222).

2. The court of appeals, although holding that the contracts were not terminable at Paragon's will, did not in terms disturb the Tax Court's finding that Paragon was legally free to set the tipple price at whatever level it chose. And on this record, we do not believe it possible to find any legally enforceable standard by which Paragon was bound in setting the price. The lack of an enforceable price standard would in turn make the purported contract right to mine to exhaustion of little substance, since Paragon, by setting the price so low as to be noncompensatory, could effectively force the contract miners to exercise their right to terminate the contracts. In view of the intimate relationship between the power to terminate a contract and the power unilaterally to change

^{*}That would not, however, make the nonterminability of the contracts entirely illusory. A termination right would permit Paragon to terminate a single contract and not others. Assuming nonterminability, however, Paragon was surely required, at a minimum, to offer the same tipple price to all its contractors, and thus could not use its control over the tipple price to force a single contractor to quit work.

the price at which it is to be performed, the court's evident inability to find an enforceable price standard casts additional doubt on its finding that the contracts were intended to be terminable only by the miners and not by Paragon.

Another way of resolving the anomaly, while respecting the finding of nenterminability, would be to find an implied undertaking by Paragon to set the tipple price, at least if market conditions permitted it, at a level that would permit the miners to earn a fair return for their services. At most, however, Paragon would be obligated to pay only the reasonable value of the contractors' services. What is reasonable compensation for services would in turn vary not only with changes in labor costs in the area but also, to a degree, with the profitability of the business. In a limited sense, therefore, such an obligation would give the miners, in the court of appeals' words, a right "to be paid [for the coal mined] at a price which was closely related to the market price" (R. 255). But even if Paragon was legally obligated to set the tipple price at a level that would fairly compensate the miners for their services, it was plainly still paying only for services and not for the right to own and

of in fact, we do not believe the court of appeals purported to find a legally enforceable price standard. All it seems to have meant by the quoted phrase was that the miners had a right to be paid the price posted by Paragon and that the posted price was in fact. "closely related to the market price." Whether the relationship of the tipple price to the market price for coal was the product merely of economic forces or of legal compulsion seems not to have been a matter of concern to the court of appeals.

sell the unmined mineral deposit. If the contract miners demanded an amount in excess of the fair value of their services, Paragon remained free to refuse and to substitute another contractor, thus retaining for itself the full value of the unmined mineral deposit.

In short, the contract miners had no right to share in the value of the unmined mineral deposit; at most they had a right to payment for their services. And without a right to share in the value of the deposit, the miners had no depletable capital or economic interest in the mineral in place.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed both in No. 134 and in No. 237. If, however, the judgment in No. 237 is affirmed, the judgment in No. 134 should also be affirmed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., Petitioner,

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF OF JEWELL RIDGE COAL CORPORATION IN SUPPORT OF PETITIONER

Jewell Ridge Coal Corporation, with written consent of all parties to the case, which consents are on file with the clerk, respectfully presents this brief on the merits in support of petitioner.

INTEREST OF AMICUS CURIAE

Petitioner Paragon Jewel Coal Company's position in the present case is similar to that of Jewell Ridge Coal Corporation in Commissioner v. Raymond E. Cooper, et al., No. 262, this Term, decided by the court below on the same day (330 F. 2d 163). The Commissioner's petition for writ of certification in No. 262 was not granted pending decision in the present case. We understand that the Commissioner will take no further action to obtain a writ in No. 262, but instead will ask that it be disposed of in accord with the outcome here.

For reasons argued in their respective briefs, the Commissioner and Paragon are in agreement that the present case and No. 262 were wrongly decided by the Court of Appeals and that both should be reversed. Jewell Ridge agrees with the Commissioner's and Paragon's positions, but in our view the decisions of the Court of Appeals, here and in No. 262, were wrong for fundamental and important reasons which, we understand, will nevertheless not be argued in either the Commissioner's or Paragon's brief, but which are set forth in this brief.

Jewell Ridge also believes that two or more essential facts in No. 262 make it an even stronger case for the Commissioner's position than this one, so that if the present case is reversed No. 262 should be also. If the present case is affirmed the Commissioner's petition in No. 262 should be granted for consideration of the additional arguments, also fundamental and important, which are available to the Commissioner in that case. One of those arguments, mentioned only collaterally in the Commissioner's brief in No. 262 before the court below, is that there was an express understanding between Jewell Ridge and its contract mine operators

that Jewell Ridge could, as it did, maintain complete, unilateral control over the amount of coal which its contract mine operators were from time to time permitted to mine. The Commissioner nevertheless took the position below that the question and the governing legal principles were substantially the same in No. 262 as in the present case, and the court below disposed of No. 262 on the basis of its decision in the present case. For the reasons mentioned, such action should be taken here only if the present case is reversed.

SUMMARY OF ARGUMENT

I. The depletion deduction is a return of capital to the owner of a wasting asset for the part used in production. The owner's cost of his capital interest is unimportant, as is the legal form of his ownership. But the claimant's legally enforceable rights must constitute ownership, the resulting economic right must be a capital interest and that interest must be in the wasting asset, the mineral deposit in the ground. A claimant's right to depletion can, therefore, be tested by inquiring whether, as a matter of substance, without regard to mere formalities, his legally enforceable rights are equivalent to ownership of an undivided legal interest in the mineral in place, which in this case was coal.

A. One such right is legal control. An owner of capital invariably has, at some point in time, complete legal control of his capital, i.e., an economic right capable of realization as gross income solely by the exercise of his enforceable legal rights in the mineral deposit. But in this case, even if the contract mine operator's contract was non-terminable (which is indispute), his only legal rights were to perform the

presumably, so long as he performed satisfactorily, to prevent production of the coal without his participation. These two rights, taken separately or together, do not constitute ownership of a capital interest in a mineral deposit, since an exclusive contract to perform services is not a capital interest and since a right to prevent production without one's participation falls short of complete legal control of capital.

B. Another such right, closely associated with the first, is the possibility of profit. As an owner of capital, the holder of a depletable interest has a legally enforceable right to a share in the value of the mineral deposit. But in the present case there was no direct or indirect contractual or other legal linkage between the value of the coal extracted and the amount to which the operators were entitled. If the operators' costs of labor went down, or the leaseholder's costs of production increased, the leaseholder (Paragon) could decrease the amount paid operators, even though the price of coal remained stable. Or if the price of coal increased Paragon might keep nearly all the increase or pass along most of it to the operators, depending on the relative bargaining positions of the parties at the time. The contract mine operator did not have a fixed or determinable right to share in the value of the mineral deposit, and hence his right to payment was not depletable.

C. A third characteristic of ownership of a wasting capital asset is that the owner's income is dependent solely on the mineral extracted from the deposit in which he has an interest. If his income can come from another source it is not depletable. In this case, however, the contract mine operator's income was not dependent solely on the mineral extracted from the de-

posit in which he claimed an interest. Each operator received the same amount per ton, without regard to the quality of the coal he mined, and insofar as amounts paid an operator came from coal, the source was all the coal mined from Paragon's leasehold, not the coal he mined. Consequently the interest claimed was not a depletable one.

II. That the operator made an investment is neutral in determining whether the legal right in which he invested was the ownership of a capital interest. Since the analysis summarized above shows that the operators' contracts lacked at least three essential attributes of a depletable interest and were, in essence, agreements to perform services for pay under a piecework method of compensation, the operators' investments were in their employment contracts, not in the coal in place.

ARGUMENT

Under principles declared by this Court in Palmer v. Bender, 287 U.S. 551, 557, and applied by every subsequent decision of this Court, a taxpayer is entitled to depletion where he has: (1) acquired, by investment, any interest in the mineral in place and (2) secured, by legal relationship, income derived from the extraction of the mineral, to which he must look for a return of his capital. Parsons v. Smith, 359 U.S. 215, The Court of Appeals purported to find these two requisites in what it thought were the contract mine operator's non-terminable rights, under his contract, (a) to mine the coal under a specific surface area to exhaustion and (b) to be paid therefor at a price which was closely related to the market price (R. 254-255). In so doing, the court below misconceived the principles laid down by this Court, as will now be shown.

The Contractor Did Not Acquire, By Investment, Any Capital Interest in the Coal in Place

In the case of mines and other natural deposits, sections 611(a) and 613(b)(4) of the Internal Revenue Code of 1954 ("Code") permitted for the years here involved, as a deduction from gross income, "a reasonable allowance for depletion" which, in the case of coal, was limited to ten percent "of the gross income from [mining]" the property". Section 614(a) of the Code defined the term "property" as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land."

The purpose of the depletion deduction and the content of the term "interest" has been spelled out in decisions by this Court. "[T]he deduction is to be regarded as a return of capital, not as a special bonus for enterprise and willingness to assume risks. * In essence, the deduction for depletion does not differ from the deduction for depreciation" (United States v. Ludey, 274 U.S. 295, 303). "The deduction is permitted * * * in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production. The granting of an arbitrary deduction * * * of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance" (Helvering v. Bankline Oil Co., 303 U.S. 362, 366-367).

¹ Section 613(c) provided that "the term 'gross income from the property' means the gross income from mining" and that "'mining' includes not merely the extraction of the ore from the ground, but also the ordinary treatment processes normally applied by mine owners or operators to obtain the commercially marketable mineral product" including (in the case of coal) "cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment."

"While there are income incidents to the utilization of natural resources, there is also an obvious exhaustion of the capital used to produce the income. theory the aggregate sum allowed for depletion would equal the value of the natural resource at the time of its acquisition by the taxpayer, so that at the exhaustion of the resource the taxpayer would have recovered through depletion exactly his investment. ministrative difficulties in taxation of oil and gas production in view of the uncertainties of quantities and time of acquisition, that is at the purchase of the property or at the discovery of oil or gas, finally have brought Congress to the arbitrary allowance of 271/2 per cent² now embodied in § 114(b)(3).3 Thus, the 271/2 per cent is appropriated by the statute to the restoration of the taxpayer's capital and the rest of the proceeds of the natural asset becomes gross income. It follows from this theory that only a taxpayer with an economic interest in the asset, here the oil, is entitled to the depletion" (Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 602-603, footnotes added). "In short, the purpose of the depletion deduction is to permit the owner of a capital interest in mineral in place to make a tax-free recovery of that depleting capital asset" (Parsons v. Smith, 359 U.S. 215, 220).

"It is true that the right to the depletion allowance does not depend upon 'any particular form of legal interest in the mineral content of the land'" (Helvering v. Bankline Oil Co., 303 U.S. 362, 367). The decisions of this Court have rested upon "practical consequences", and not "upon the particular instrument involved, or upon the formalities of the conveyancer's

² Ten per cent for coal.

³ Predecessor of Code § 613(b)(1).

art" (Anderson v. Helvering, 310 U.S. 404, 411). But "[t]echnical title to the property depleted would ordinarily be required for the application of depletion or depreciation" (Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 33), and "ownership" of an interest in the mineral is "essential" (Thomas v. Perkins, 301 U.S. 655, 661).

In Lynch v. Alworth-Stephens Co., 267 U.S. 364, involving oil and gas leases which (p. 369) "did not convey title to the unextracted ore deposits", the "interest" which was "property" and hence depletable was "the exclusive possession of the deposits and the valuable right of removing and reducing the ore to ownership." These very same legal rights were described in Palmer v. Bender, 287 U.S. 551, as (p. 557) "legal control of a valuable economic interest in the ore capable of realization as gross income by the exercise of his mining rights under the lease" and as (p. 558) "complete legal control of the oil in place".

Helvering v. Bankline Oil Co., 303 U.S. 362, in which a gas processor who had not acquired complete legal control of the gas in place was denied a depletion deduction, distinguished between a depletable "economic interest" in the mineral deposit and a non-depletable "economic advantage" through contractual relation to the owner, as follows (pp. 367-368):

"But the phrase 'economic interest' is not to be taken as embracing a mere economic advantage derived from production, through a contractual relation to the owner, by one who has no capital investment in the mineral deposit.

[&]quot;Undoubtedly, respondent through its contracts obtained an economic advantage from the produc-

tion of the gas, but that is not socient. The controlling fact is that respondent had no interest in the gas in place. Respondent had no capital investment in the mineral deposit which suffered depletion and is not entitled to the statutory allowance."

Helvering v. O'Donnell, 303 U.S. 370, drew the same distinction where an owner of one-third the stock in a corporation had no "interest" in a mineral deposit owned by the corporation, and did not acquire such an interest by contracting to sell as shares for a price measured by the purchaser's net profits from exploitation of the deposit (which the purchaser agreed to acquire), the Court stating (p. 372):

"As consideration for his stock in the San Gabriel Company respondent bargained for and obtained an economic advantage from the [purchaser's] operations but that advantage or profit did not constitute a depletable interest in the oil and gas in place."

An owner of "interests" in a mineral deposit, who transferred these for an amount payable either from minerals produced out of the deposit or from sale of fee title to the very same land, did not retain such an "interest", that is "a capital investment in the oil and gas in place", since the payments (which actually were made entirely from oil so produced) were "not dependent entirely upon the production of oil" and might under the contract "be derived from sales of the fee title to the land conveyed" (Anderson v. Helvering, 310 U.S. 404, 407, 412). The Court stated (p. 413):

"In the interests of a workable rule, [prior eases] must not be extended beyond the situation in which, as a matter of substance, without regard to

formalities of conveyancing, the reserved payments are to be derived solely from the production of oil and gas."

Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, involved a fee simple owner of land who leased it for the production of oil and gas in consideration for a cash bonus, a royalty in usual form and a share of the net profits realized by the lessees from their operations under the lease. Referring (p. 606) to the taxpayer in O'Donnell as "a stranger to the lease" and to Anderson v. Helvering as having "correctly stated that a share in 'net profits', disassociated from an economic interest, does not entitle the holder to a depletion allowance", the Court held (p. 604):

"If the additional payment in these leases had been a portion of the gross receipts from the sale of the oil extracted by the lessees instead of a portion of the net profits, there would have been no doubt as to the economic interest of the lessors in such oil. This would be an oil royalty. The lessors' economic interest in the oil is no less when their right is to share a net profit. As in Thomas v. Perkins, 301 U.S. 655, their only source of payment is from the net profit which the oil produces. In both situations the lessors' possibility of return depends upon oil extraction and ends with the exhaustion of the supply. Economic interest does not mean title to the oil in place but the possibility of profit from that economic interest dependent solely upon the extraction and sale of the oil."

Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, differed from Kirby in that the depletion claimant, in consideration for transferring his legal control of the oil deposit to another, retained 50 percent of the net proceeds from the oil deposit but no accompanying

royalty. The Court again held the assignee-assignor taxpayer entitled to depletion, stating (p. 33):

"Since lessors as well as lessees and other transferees of the right to exploit the land for oil may retain for themselves through their control over the exploitation of the land valuable benefits arising from and dependent upon the extraction of the oil, Congress provided * * for equitable apportionment of the depletion allowance between them to correct what was said to be an existing inequality in the law or its administration.

"In the present case, the assignor of the petitioner before assignment had an economic interest in the oil in place through its control over extraction. Under the contract with petitioner, its assignor retained a part of this interest-fifty per cent of net. Like the other holders of such economic interest through royalties, the petitioner looked to the special depletion allowance of § 114 (b)(3) to return whatever capital investment it had. The cost of that investment to the beneficiary of the depletion under § 114(b) (3) is unimportant. Depletion depends only on production. It is the lessor's, lessee's or transferee's 'possibility of profit' from the use of his rights over production, dependent solely upon the extraction and sale of the oil,' which marks an economic interest in the oil."

U.S. 308, dealt with an upland owner who exchanged the use of his property for contract rights to centrol production from an oil deposit and 24½% of the net proceeds from the deposit. The Court recited the two requisites for an economic interest from Palmer v. Bender, stating as to the second factor (p. 314):

"The second factor has been interpreted to mean that the taxpayer must look solely to the ex-

traction of oil or gas for a return of his capital, and depletion has been denied where the payments were not dependent on production, Helvering v. Elbe Oil Land Co., 303 U.S. 372, or where payments might have been made from a sale of any part of the fee interest as well as from production. Anderson v. Helvering, 310 U.S. 404. It is not seriously disputed here that this requirement has been met. The problem revolves around the requirement of an interest in the oil in place" (italics in original).

Finally, Parsons v. Smith, 359 U.S. 215, dealt with a contract coal miner whose contractual relationship with the owner of the coal deposit was, in essence, the performance of services for pay under a piecework method of compensation. The Court refused to find that the contract miner had, in effect, exchanged his agreement to perform services for a depletable capital interest in the coal in place, stating (p. 224, 226):

* petitioners simply agreed to provide the equipment and do the work required to strip mine coal from designated lands of the landowners and to deliver the coal to the latter at stated points, and in full consideration for performance of that undertaking the landowners were to pay to petitioners a fixed sum per ton. Surely those agreements do not show or suggest that petitioners actually made any capital investment in the coal in place, or that the landowners were to or actually did in any way surrender to petitioners any part of their capital interest in the coal in place. Petitioners do not factually assert otherwise. Their claim to the contrary is based wholly upon an asserted legal fiction. As stated, they claim that their contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a

capital investment in, and the acquisition of an economic interest in the coal in place.

"Of course, the parties might have provided in their contracts that petitioners would have some capital interest in the coal in place, but they did not do so—apparently by design. Instead, petitioners simply entered into contracts, terminable without cause on short notice, with the owners of coal-bearing lands to provide the equipment and do the work required to strip mine and deliver coal from those lands, as independent contractors, for fixed unit prices."

The foregoing distillation of cases from Ludey through Parsons demonstrates that this Court's decisions are all consistent in spelling out the essential requisites of a depletable interest in the light of the statute's constant purpose. The depletion deduction is a return of capital to the owner of a wasting asset for the part used in production. The owner's cost of his capital interest is unimportant, as is the legal form of his ownership. But ownership and capital it must be. Hence entitlement to the deduction is to be tested by determining whether, as a matter of substance, without regard to mere formalities, the taxpayer's legally enforceable rights are equivalent to ownership of an undivided legal interest in the mineral deposit in place.

One such right is legal control. An owner of capital invariably has, at some point in time, complete legal control of his capital. The owner of a depletable interest must likewise, acquire complete legal control of a valuable economic right capable of realization as gross income solely by the exercise of his enforceable legal rights in the mineral deposit. Another such right,

closely associated with the first, is the possibility of profit. As an owner of capital, the holder of a depletable interest has a legally enforceable right to a share in the value of the mineral deposit. A third characteristic of ownership of a wasting capital asset, is that the owner's income from production is dependent solely on exhaustion of the mineral deposit in which he has an interest, so that if his income can come from another source it is not depletable.

These three characteristics, although not necessarily the minimum requisites nor exclusive tests, are essential and must be found in every depletable interest. On the other hand, compensation for services is not depletable, so that in every case where a taxpayer claims to have exchanged his agreement to perform services for a depletable capital interest in a mineral deposit, the rights of the parties must be examined closely to see whether such an exchange of services for property can be deemed to have occurred.

A. THE COAL AT ALL TIMES, EVEN AFTER IT WAS MINED. BELONGED SOLELY TO PARAGON.

Here, as in *Parsons*, a basic difficulty faced by the contract mine operators is that their contracts were, in essence, to perform services for pay, and provide incidental equipment and facilities to do the work, under a piecework method of compensation, measured by the number of tons of coal mined and delivered to the owner. Compensation for services is non-depletable ordinary income. Hence the operators necessarily must contend that the pay they received was not for the services they performed. This they do by contending that they, in effect, exchanged their agreements to perform services for a "capital interest" in the coal in place, which they then transferred back to the owner,

reserving a "possibility of profit" from that capital interest "dependent solely upon the extraction and sale" of the coal. A pertinent inquiry, then, is whether such a constructive exchange of services for property should be deemed to have occurred in this case.

The Court of Appeals throught that in this case there was such an exchange, even though it apparently would convert ordinary income into a tax-free return of capital. The appellate court also thought that Parsons was distinguishable, since there the contract miner's rights to extract and deliver coal were terminable by the owner without cause on short notice, whereas in the present case the Court of Appeals believed that each contract mine operator had a right to mine the coal under a specific surface area to exhauston. But even if such a right existed (a matter disputed by both Paragon and the Government), the right was not a depletable interest, as shown by the following analysis.

It is plain that unless and until the coal was mined by the operators they did not own a single ton. If they quit, as they were entitled to do, they could not transfer their rights to another, nor could they take any coal

⁴ Under the first (P-22) of six Huss contracts in Parsons v. Smith, the coal deposit owner had only "the right to temporarily suspend work under this contract at any time or times by giving Contractor written notice". If the suspension continued for a period of five weeks, Contractor had only the right to elect to terminate the contract (contract provision printed 150 F. Supp. 224, 229, fn. 7). The Government's brief treated this contract (P-22) as, in effect, terminable at will by the owner (Nos. 218 and 305, Oct. Term, 1958, Respondent's brief, p. 11, fn. 7). Cf. GCM 26290, 1950-1 CB 42, 46 (next to last paragraph); Mammoth Coal Co., 22 T.C. 571, 576, rev'd on this point 229 F. 2d 535, 538 (CA 3), cert. den'd 352 U.S. 824.

⁵ The Tax Court found that the operator's right to mine in an area was non-exclusive (R. 223, lines 12-30), while the Court of Appeals said nothing on the point. Cf. Denise Coal Co. v. Commissioner, 271 F. 2d 930, 933 (CA 3).

with them. They had only the right, personal to them, to mine the coal in a specific area to exhaustion. Similarly, when and as the coal was mined, it belonged solely to Paragon, and the operators could not sell or keep any of it, but were required to deliver all that they mined to Paragon. Hence the only legal rights which an operator had were (1) to perform the service of extracting and delivering the coal and (2) presumably, so long as he performed satisfactorily, to prevent production of the coal without his participation.

. It should be plain that these two rights, taken separately or together, do not constitute ownership of an interest in the mineral deposit. An exclusive contract to perform services is just that and nothing more. Similarly a right to prevent production from a mineral deposit without one's participation is not equivalent to ownership of an interest in the mineral deposit. In Helvering v. Bankline Oil Co., 303 U.S. 362, where a gasoline extractor had invested in (p. 365) "necessary pipe lines and connections from casingheads or traps. at the mouth of the well to its plant" and had acquired a contract right (p. 367) "to a delivery of the gas produced at the wells", the Court held that the extractor's right to prevent production without his participation was (p. 368) "no interest in the gas in place". That decision was sound, since one whose rights in a mineral deposit are limited to either participating in or preventing production has not "acquired legal control of a valuable economic interest capable of realization as gross income by the exercise of his mining rights".7

⁶ See footnote 5, supra.

⁷ Palmer v. Bender, 287 U.S. 551, 557.

Such a person has no "'possibility of profit' from the 1 se of his rights over production".8 Rather, in common with any person who has a monopoly of machinery necessary for extraction, or of transportation necessary to carry the mineral from mine to processing plant, or of surface rights necessary for extraction or haulage, unless and until one holding such a monopoly exchanges it for "complete legal control of the [mineral] in place" he has no "ownership" of an "interest" in the mineral deposit. Commissioner v. Southwest Exploration Co., 350 U.S. 308, is not to the contrary, since there the upland owners, in exchange for (p. 316)"the use of their land", acquired both an "agreement with [Southwest] setting forth in detail the procedures to be followed by Southwest in conducting operations from the uplands'" and a contract right to (p. 309) "241/2% of the net profits" from the oil deposits. Thus the upland owners in Southwest Exploration acquired what the contract mine operators in the present case lacked, namely "ownership" of an "interest" in the mineral deposit. Here as in Parsons v. Smith the contract miners did not acquire legal control of the coal deposit and hence they had no depletable capital interest in the coal in place.

⁸ Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 34.

⁹ Palmer v. Bender, supra, at 558.

¹⁰ Par. 14, U.S. Court of Claims Findings of Fact, 132 F. Supp. 718, 725. The contract rights acquired by the upland owners included rights to control "the surface location and subsurface course of [Southwest's] wells, * * the location of all surface facilities, the quality of all equipment to be used by [Southwest] in connection with such facilities and the manner of performing all drilling and other operations by [Southwest]" (Findings Par. 27, 132 F. Supp. 718, 727).

B. THE CONTRACTOR DID NOT ACQUIRE THE REQUISITE POSSIBILITY OF PROFIT DEPENDENT SOLELY UPON EXTRACTION OF THE COAL.

There is another and an equally serious difficulty across the contract mine operator's path in the present case. In Parsons v. Smith the operator's piecework rate of compensation was fixed,11 whereas here it was Rather, prospective price changes were made by Paragon12 at will, 18 the contractors were notified several days in advance of any price change,14 the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs,16 and there was no evidence that the amount paid by Paragon was directly related either to the price it was getting for the coal or to the sales price of a particular contractor's coal.16 The Court of Appeals stated that "the operators had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price."17 but (even if this were true) such price could be changed by Paragon on short notice18 and, subject to the opera-

¹¹ The piecework rates under both the Parsons and the Huss contracts were subject to increase sufficient to cover higher labor costs, but were not otherwise subject to change (359 U.S. 215, 217, 218).

¹² R. 214.

¹⁸ R. 222.

¹⁴ R. 214.

¹⁵ R. 222.

¹⁶ Ibid.

¹⁷ R. 255.

¹⁸ R. 86, 87, 93, 105, 118-120, 142, 144.

tor's right to quit at any time, 19 the new price could be determined unilaterally by Paragon.20

The Tax Court concluded that the amount payable to the contract mine operators was changeable at the will of Paragon, and this was not contradicted by the Court of Appeals. Jewell Ridge agrees, therefore, with the Government's argument in its brief that Paragon's right to set and change the amount paid operators precludes any contention that an operator had a depletable capital interest in the mineral deposit.

But even if the immediately foregoing view were not correct, and even if this Court were to conclude that Paragon did not have an unrestricted right to set and change the amount paid operators, it would not follow that the operators had a depletable interest in the coal in place.

The record is plain that, even though the amount paid by Paragon "was closely related to the market price" in the sense that when times were good Paragon paid more and when times were bad it paid less, there was no agreement that, if the market price of coal increased a specified amount per ton, the amount paid the operator would increase proportionately, nor was there any agreement that, if the market price of

¹⁹ R. 255, lines 19-23.

²⁰ R. 49, 50, 51, 56, 64-65, 86, 87, 90-91, 93, 105, 106, 118-120, 142, 144, 169, 185-186; see also R. 114, 136, 147, 170, 180.

²¹ R. 222.

²² See R. 254, lines 13-15, R. 255, lines 27-29.

²⁸ R. 255.

²⁴ R. 96, 118-120, 222, 230, 250.

coal decreased to a specified extent, the amount paid operators would decrease proportionately.25 Instead it was understood that the amount paid operators could be prospectively increased or decreased by Paragon on short notice20 and in so doing Paragon was entitled to and did take into account its competitive position in the market place, at the amount paid contract mine operators by other coal producers,28 the costs of operations (both the contractors 200 and Paragon's so), the market price of coal, and possibly other factors.32 Thus, in February 1952 there was a substantial increase in the amount paid operators even though the market price had not increased for months;34 there was no decrease in the amount paid operators from February to October, 1952, 35 although the market price fell in that period; 36 and there was a further increase in October, 1952st due to an increase

²⁵⁻Tax Court, R. 222; Testimony, R. 95, 96.

²⁶ Court of Appeals, R. 254; Tax Court, R. 214; Testimony, R. 86, 87, 93, 105, 118-120, 142, 144.

²⁷ R. 169, 186; see also R. 45, 50, 51, 56, 114, 119, 120, 136, 147.

²⁸ R. 50, 102, 143; see also R. 46, 48, 49, 109-110, 133-134, 148.

²⁹ R. 119, 120, 147, 178; see also R. 116-117, 141.

³⁰ R. 51, 102, 169.

⁸¹ R. 50, 56, 114, 119-120, 136, 147, 170, 180; but see 65, 94, 95, 96, 128, 141-142, 144.

³² R. 106, 117, 123; see also R. 50, 56, 67, 90-91.

⁸⁸ R. 118, 230.

⁸⁴ R. 250.

⁸⁵ R. 119, 230.

³⁶ R. 250.

⁸⁷ R. 119, 230.

in the operators' costs of labor. It follows that if the operators' costs of labor went down, or Paragon's costs of production increased, Paragon might decrease the amount paid the operators, even though the market price of coal might have remained stable. Similarly, if the market price of coal increased, Paragon might keep a lion's share of the increase, or it might pass along nearly all the increase to the contract operators, depending upon the relative bargaining position of the parties at the time. In short, there was no direct or indirect contractual or other legal linkage between the value of the coal extracted and the amount to which the operators were entitled.

This Court has never held that such a right to payment constitutes "ownership" of an "interest" in a mineral property; nor should it. As the Court stated in Palmer v. Bender, 287 U.S. 551, a depletable interest is (p. 557) "legal control of valuable economic interest in the ore capable of realization as gross income by the exercise of his mining rights". Capsulated in Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 604, "economic interest does not mean title to the oil in place but the possibility of profit from that economic interest dependent solely upon the extraction and sale of the oil." Or as rephrased by the Court in Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 34, "it is the lessor's, lessee's or transferee's 'possibility of profit' from the use of his rights over production, 'dependent solely upon the extraction and sale of the oil', which marks an economic interest in the oil."

As the foregoing decisions show, the economic right which the holder of a depletable interest owns is the

⁸⁸ R. 119.

same in substance as that held by the owner of an undivided legal interest in the mineral property itself. The depletable interest may be in the form of a fixed amount for each unit of the mineral produced, or it might be a right to a fraction of each unit extracted, or a right to a portion of either the gross profits or the net profits realized from the mineral. But except where the right is to a fixed amount or fraction, or where a party bearing more than his share of the costs is permitted to recoup his excess costs from the first production, each owner of a depletable interest will share proportionately in profits realized to the extent of his interest. Thus in a case without fixed, temporary or limited payment rights, if the costs of production were to go down while the market value of the mineral remained stable, each owner of a depletable interest would share proportionately in the profits realized. Similarly if the market value of the mineral increased while the costs of production remained stable, each such owner would likewise share proportionately in the profits. And if the costs of production went down while the market value of the mineral increased, each such owner would profit doubly. In sum, the owner of a depletable interest has an enforceable legal right to a fixed or determinable share in the value of the mineral deposit.

In the present case, as has been shown, the contract mine operators had no such right. There was no agreement that the amount paid would remain fixed. Nor was there any agreement as to each party's share of increases or decreases in market price. There was no direct or indirect contractual or other legal linkage between the value of the coal extracted and the amount to which the operators were entitled. The contractor did not have a fixed or determinable right to share in the value of the mineral deposit, and hence his contract right to payment failed an essential test of a depletable interest.

C. THE CONTRACTOR'S INTEREST, IF ANY, WAS IN PARAGON'S TOTAL OPERATION, NOT IN THE COAL HE MINED.

In the present case, Paragon installed a road running around a mountain close to the outcrop line of the coal, contracting with numerous mine operators to mine and deliver the coal to Paragon's tipple, where Paragon cleaned, sized and sold the coal. The coal as delivered to the tipple was not salable, but had to be washed, graded and treated to be salable.40 In the process, the coal mined by all the operators was mixed together, the rock, dirt and other extraneous matter was removed, and the coal was washed, sized, graded and oil treated, emerging as four different grades of coal, each of which sold at a different price.41 contractor, however, was paid so much a ton, regardless of the quality or market value of the particular. coal he mined.42 Thus, though the amount paid contractors "was closely related to the market price," 48 in the sense that when times were good Paragon paid more and when times were bad it paid less." the amount paid a contractor was neither fixed nor dependent solely upon either the market value or the sale price

³⁹ Cour of Appeals, R. 253-254; Tax Court, R. 211-212.

⁴⁰ R. 216.

⁴¹ R. 95, 96.

⁴² R. 168, 222.

⁴⁸ R. 255.

⁴⁴ R. 96, 118-120, 222, 230, 250.

of the coal underlying the "specific surface area" allocated to him. Hence, even if the contractor were deemed to have a profit interest in the coal (which he did not*) and even if Paragon's income from coal were deemed the sole source of amounts payable to contractors (which it was not*), the source of a contractor's profit was all the coal mined from Paragon's leasehold, not the coal he mined.

This Court frequently has announced that to have a depletable interest the claimant's possibility of profit must be dependent solely upon extraction of the mineral from the deposit in which he claims an interest, and the Court has not allowed depletion in any case except where this was true. In Anderson v. Helvering, 310 U.S. 404, depletion was denied where the amounts paid actually came out of the minerals produced from the deposit, but where under the contract such amounts. might have been derived from sales of fee title to the land containing the deposit. As expressed in Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 604: "Economic interest means] the possibility of profit from that economic interest dependent solely upon the extraction and sale of the oil." Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, stated (p. 34): "Depletion depends only upon production. lessor's, lessee's or transferee's 'possibility of profit' from the use of his rights over production, 'dependent solely upon the extraction and sale of the oil' which marks an economic interest in the oil." Thus, in Commissioner v. Southwest Exploration Co., 330 U.S. 308. the Court said (p. 314):

> "The second factor has been interpreted to mean that the taxpayer must look solely to the extrac-

^{3.45} R. 254.

⁴⁶ Parts A and B, supra, pp. 14-23.

⁴⁷ Amounts due contractors were payable from all Paragon's resources, including borrowed and equity capital (R. 216).

tion of oil or gas for a return of his capital, and depletion has been denied where the payments were not dependent on production [citing Helvering v. Elbe Oil Land Co.], or where payments might have been made from a sale of any part of the fee interest as well as from production [citing Anderson v. Helvering]." (italics in original)

The principle reflected in the mentioned decisions is sound. The purpose of the depletion deduction is to permit the owner of a capital interest in a mineral deposit to make a tax-free recovery of the part used up in production (Parsons v. Smith, 359 U.S. 215, 220). In theory the aggregate sum allowed for depletion would equal the value of the deposit at the time of its acquisition by the taxpayer, so that at the exhaustion of the resource the taxpayer would have recovered through depletion exactly his investment (Kirby Petroleum Co. v. Commissioner, 326 U.S. 599, 602-603). In essence, the deduction for depletion does not differ from the deduction for depreciation (United States v. Ludey, 274 U.S. 295, 303). It follows that, to constitute a depletable interest in a mineral deposit, the owner's return must be entirely dependent upon extraction of the mineral from that deposit, so that none of his return could come from any other source, for otherwise it would be necessary to trace each dollar to its source to be sure that it represented a recovery of the depletable interest (Anderson v. Helvering, 310 U.S. 404, 413). .

In the present case, the contract mine operator's income was not dependent solely upon the mineral extracted from the deposit in which he claimed an interest. The coal underlying his "specific surface area" might have been the lowest quality on Paragon's leasehold. It is inherently improbable that the yield of high and low grade ores would be in exactly the same proportion from each mine; and the record shows that

the characteristics of the coal seam varied/sharply from mine to mine, sometimes within short distances.48 Yet each contract mine operator received the same amount per ton, without regard to the quality of the coal he mined.49 Thus, to such extent as an operator's income actually came from Paragon's, the amount paid each operator came, in part, out of proceeds from the coal he mined and, in part, out of proceeds from the coal mined by all the other operators. No operator's income was dependent solely on extraction of the coal from the area in which he claimed an interest. Rather the source of an operator's income, insofar as it actually came from coal, was all the coal mined from Paragon's leasehold, and not the coal mined by the operator. Consequently the interest claimed by the contract mine operator was not depletable.

II. The Contractor's Investment Was in His Employment Contract, Not in the Coal in Place

Concededly the contract mine operators invested time and money in their mining operations.⁵⁰ The same was true in *Parsons.*⁵¹ It is equally clear that the amount of the operator's investment is unimportant.⁵² But the fact that the operator made an investment is entirely neutral in determining whether the legal right in which he invested was the ownership of a capital

⁴⁸ R. 35 (lines 11-13), 44 (23-34), 49 (24-28), 67 (1-10), 95 (7-14), 101 (10-14), 123 (30-39).

⁴⁹ R. 86, 105, 128, 185.

⁶⁰ R. 255.

⁵¹ Parsons v. Smith, 359 U.S. 215, 217, 218, 223,224.

⁶² Burton-Sutton Oil Co. v. Commissioner, 328 U.S. 25, 34; Commissioner v. Southwest Exploration Co., 350 U.S. 308, 312.

interest in the coal in place. For if upon analysis the facts further show that the contractual relation in which the operator invested was an economic advantage derived from production, rather than ownership of a capital interest in the coal in place, the operator is not entitled to share in the depletion deduction. **

In the present case, analysis discloses that the operators' contracts lacked at least three essential attributes of a depletable interest. First, their contracts were, in essence, to perform services for pay, and provide incidental equipment and facilities to do the work, under a piecework method of compensation. But such contracts, if deemed non-terminable (a matter of dispute). they acquired rights to perform the service of extracting and delivering the coal and, presumably.55 so long as they performed satisfactorily, to prevent production of the coal without their participation; but they did not acgnire legal control of the coal deposit, which remained in Paragon.56 Second, the operators did not have a fixed or determinable right to share in the value of the mineral deposit, so that their contract rights fell short of an ownership interest.57 Third, insofar as amounts paid an operator came from coal, the source was all the coal mined from Paragon's leasehold, and not the coal he mined. No operator's return was dependent solely on extraction of the coal from the area in which he claimed an interest, and hence the claimed interest was not depletable.58 These being the facts, it is apparent

⁵⁸ See Helvering v. Bankline Oil Co., 303 U.S. 362, 368; Parsons v. Smith, 359 U.S. 215, 225-226.

⁵⁴ Ibid.

⁵⁵ See footnote 5, supra.

⁵⁶ Part A, supra, pp. 14-17.

⁵⁷ Part B, supra, pp. 18-23.

⁵⁸ Part C, supra, pp. 23-26.

that the operators' investments were in their employment contracts, not in the coal in place.

CONCLUSION

The judgment of the Court of Appeals, permitting depletion deductions to the contract mine operators, should be reversed and remanded for entry of an order affirming the Tax Court.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM 1964

No. 237

COMMISSIONER OF INTERNAL REVENUE, Petitioner

ROBERT LEE MERRITT, ET UX., ET AL.

On Writ of Certiorari To the United States Court of Appeals for the Fourth Circuit

BRIEF FOR RESPONDENTS

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No. 237

COMMISSIONER OF INTERNAL REVENUE,
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ROBERT LEE MERRITT, ET UX., ET AL.

On Writ of Certiorari To the United States Court of Appeals for the Fourth Cheuit

BRIEF FOR RESPONDENTS

Preliminary Statement

This case is consolidated with No. 134 and this brief is in reply to the brief for the Commissioner (respondent in No. 134 and petitioner in this case, No. 237) and the brief for the petitioner filed by Paragon Jewel Coal Company, Inc., (petitioner in No. 134). Any relevant matters contained in the Amicus Curiae brief filed by Jewell Ridge Coal Corporation in support of petitioner in No. 134 will be discussed herein.

The following abbreviations will be used throughout this brief: "Comm'r. Br." refers to the Brief for the Commissioner. "Paragon

QUESTION PRESENTED

The issue in this consolidated case is whether the coal mine operators operating in various partnerships during the years 1954, 1955 and 1956 are entitled to an allocable portion of the percentage depletion allowance based on amounts received for mining coal under agreements with the sub-lessee of the mineral rights or whether the sub-lessee is entitled to deduct percentage depletion on its gross income from the property, undiminished by amounts paid to the coal mine operators for coal mined and delivered to the sub-lessee. The Tax Court decided that the sub-lessee was entitled to the entire percentage depletion deduction. The Court of Appeals for the Fourth Circuit reversed and determined that the sub-lessee is required to share the depletion deduction with the coal mine operators.

Statement of Facts

C. A. Clyborne acquired by lease and purchase certain coal bearing lands located in Buchanan County, Virginia. In 1951 Clyborne created Paragon Jewel Coal Company, Inc. (hereinafter "Paragon"), the corporate stock of which is held almost exclusively by Clyborne and his wife and he has always controlled this corporation. After Paragon was formed, Clyborne assigned leases held in his name to his corporation for an overriding tonnage royalty. This royalty was deducted by Paragon as an operating expense and reported by Clyborne as long-term capital gain.² (R. 191, 196)

Br." refers to the Brief for the Petitioner in No. 134. "Jewell Ridge Br." refers to the Amicus Curiae brief filed by Jewell Ridge Coal Corporation in support of petitioner in No. 134.

² The returns of Clyborne for the years 1955, 1956 and 1957 show that he received coal royalties from Paragon in the aggregate amount of \$471,425.93, which were deducted by that corporation as operating expenses and reported by Clyborne as long-term capital gain. (Ex. 1-A, 2-B, 3-C)

Under the assignments from Clyborne, Paragon assumed the obligations to pay minimum royalties, tonnage royalties and land taxes, all of which were deductible by that corporation as business expenses or taxes. Paragon made substantial investments for processing, shipping and marketing coal all of which were deducted as a business expense, depreciation or amortization. In fact, all expenditures of Paragon with reference to its coal operations were so deducted for tax purposes. (R. 84, 211)

In 1951 Paragon had acquired substantial acreage of coal bearing lands from Clyborne. It had erected an expensive processing plant and was committed to the payment of certain minimum royalties. Production of the coal was essential but most of Clyborne's experience had been as a sales agent, wholesaler or processer and Paragon was intended to be a processing rather than a producing coal company. Also, Paragon did not have any excess funds to invest in the coal producing business—it was in debt approximately \$300,000, was six months behind in the payment of its bills and its financial outlook was dark. Since coal mining is very hazardous, Clyborne did not want to expose his personal funds to the dangers inherent in the coal producing business. (R. 34-36, 45, 253)

The coal was to be produced by the drift mining method, which is prevalent in the Appalachia area of Virginia, West Virginia and Kentucky. Drift mining is an underground mining operation, in which a horizontal coal seam is reached by clearing away a part of the mountainside with a bulldozer. Two openings are made into the coal seam. One is an entry and the other is an air course which is used to ventilate the mine. Coal is removed as the drift mine is driven into the mountain following the seam of coal. Generally, the coal seam ranges from

³ Paragon prepaid some minimum royalties, which were all recouped as a result of the coal production of the mine operators. (R. 84)

thirty inches down to two inches, and in some places it pinches out entirely. The height of the mine is approximately thirty inches. Such shallow seams are known as "low coal", and are not capable of being mined by auto-· matic or highly mechanized equipment. The roof of the mine is supported by leaving a certain amount of coal in place known as pillars, and also erecting wooden supports every eighteen inches known as timbers. When the mine is driven to its full extent, which may be more than a mile as in some instances in this case, the pillars of coal are removed as the miners retreat. The coal is obtained from the seam either by cutting it on the bottom with a machine which yields a lump coal, or by a "solidshot" (explosion) method which yields a fine powder. Drift mining is recognized in the industry as a most difficult and economically marginal operation. (R. 43-45, 67, 101, 102, 106, 109, 116, 117, 132, 136, 150, 253).

Rather than mine the coal, Paragon elected to rely on others exclusively for production and entered into verbal agreements with coal mine operators who mined the coal. In many instances in Buchanan County, Virginia, leases to people who mine coal are oral—not in writing at all. It is a common practice in that area to transfer coal mining interests and rights by verbal agreement—such rights are transferred on the mountainside—not in law offices and the agreement is concluded by a handshake—rather than a signature and seal. (R. 37-39, 46)

In addition to equipment necessary for processing and shipping coal, Paragon installed a road running around the mountain close to the outcrop line of the am of coal over which the coal could be hauled from the mines to

^{*} Most of the coal in the Appalachia area is produced by large companies with expensive automatic and highly mechanized equipment. Drift mining is about the only means by which a small operator of moderate means can develope a mining organization and engage in the coal mining business in that area.

Paragon's processing plant. At the plant Paragon cleaned. sized and sold the coal. Beginning in 1951 Paragon entered into oral leases or agreements with a number of mine operators, including respondents in No. 237, all of which were similar in terms. Under the agreement an operator would be allocated a specific surface area under which it could mine the coal. The operator assumed Paragon's obligation to open, develop and preserve the mineral property and agreed to mine all mineable and marketable coal within that area and deliver it to Paragon at the operator's expense. Paragon agreed to handle and pay for all marketable coal produced by the operators. Paragon agreed to pay a fixed price per ton of marketable coal at the tipple, but it was understood that the price per ton would, and in fact it did, vary with the market price of coal. (R. 49, 54-56, 64, 90, 106, 114, 119, 136, 147, 180, 186, 253, 254)

All expenses of opening, developing and operating the mines were to be borne by the several operators. Such expenditures including building a road from Paragon's road to the mine entry, clearing the area at the mine site, making the installations and preparations at the mine site such as, building a tipple, laying track to the mine, obtaining machinery and equipment, installing an electric power plant and fans and the construction of several buildings. The operators were responsible for the safety and proper development of the mine and were required to obtain mining permits and develop and operate their mines in accordance with state and federal mining laws and regulations. Also, they were to pay the taxes on their equipment, obtain liability insurance, maintain proper ventilation and roof support and overcome any adverse mining conditions such as water, faulty roof and rolls. which occur when the seam of coal squeezes out. The several operators agreed to use and pay for the services of a mining engineer designated by Paragon. (R. 103, 104, 111-118, 123, 162, 167, 183, 214)

After an operator entered upon the property it would take from six weeks to two months of preparatory work before he could mine coal. Even then the operation is unprofitable. A drift mine must be developed by driving a main entry, air courses, cross sections and rooms to create enough ventilated working areas so that a sufficient daily tonnage can be produced to make the mine profitable. It took the operators from six months to a year and often longer to complete the development of their mines and reach the production stage when the mines became a profitable operation, and in some mines, they extracted all of the coal without ever attaining sufficient daily tonnage to make the mine profitable. (R. 115, 116, 123, 137, 154, 215)

Paragon agreed to and did handle all marketable coal which the several operators produced. Paragon has an exclusive contract with John McCall Company to handle all coal processed by Paragon. Coal delivered by the operators and others is delivered to Paragon's tipple, where it is processed, dumped into railroad cars and sold to John McCall Company f.o.b. at the tipple. Paragon's only contact with the coal is the brief period of time it is going through its processing plant. (R. 107, 254)

Although Paragon agreed to handle all of the operators' coal it agreed to pay only for marketable coal. If the operators delivered outcrop coal or other coal of inferior quality, Paragon could refuse to take it because it agreed to handle only coal which was marketable. Also, Paragon paid less for solid shot coal than for machine cut coal because solid shot coal is less desirable from a marketing standpoint. Finally, Paragon had no obligation to pay the operators for any adverse mining conditions. In drift mining it is not unusual to encounter water in the mine. When this occurs the mine operator must set pumps and draw the water to the outside of the mine. While this is being done, production ceases and sometimes it takes days

or even weeks to clear a watered mine. (R. 54, 106, 116, 117, 214)

The mine operators frequently encountered "rolls", which is the term used to describe the situation where the seam of coal which is generally 24 to 30 inches thick diminishes to a few inches. Thus, the mine operator has no coal to mine but must continue to drive through the sandstone. This is very expensive because of the hardness of the sandstone, which must be broken by explosives and then hauled to the outside of the mine. It was not unusual for the several mine operators to be confronted with rolls which took weeks to go through. The mine operators received nothing for going through rolls, even though it was more difficult and costly than the mining of coal. (R. 116, 117, 123, 162, 168)

The areas of coal originally leased to some of the operators involved in this litigation were enlarged by mutual agreement—the designated areas were never decreased. (R. 78, 79, 83)

The agreements were silent as to who was entitled to depletion and they contained no termination date and nothing was said between the parties on this subject. Paragon knew that: the operators would engage in large expenditures of time and money in preparing their respective sites for mining, would have to operate for a period of development before their mines would become profitable they would encounter adverse mining conditions which would be costly to overcome, and the operators could recoup therefrom only if they were able to continue mining. The operators were encouraged by Paragon to make the investments essential to the development and preservation of the mineral property. They made these investments in time and money and assumed most of Paragon's obligation under its leases because they understood that their operations could not be terminated until they had mined their respective areas to exhaustion and

that they would receive a fair price based on the conditions of the coal market for the coal which they produced. (R. 54, 65, 106, 115, 130, 137, 145-147, 156, 170, 173, 178, 185, 186, 215)

Respondents and the other mine operators involved in these proceedings have mined coal under their respective agreements from the time they were made, during the period from 1952 to 1957, until the present time. During this period, the agreements have been adhered to by both parties in accordance with the terms as described above. (R. 130, 131, 141, 143, 212, 213)

Prior to April 1957 when the case of Stilwell v. United States, 250 F.2d 736 (4 Cir. 1957) was decided, Paragon was aware of the operators' claim that they had a right to mine their respective areas to exhaustion and that the price which they were to be paid for coal produced could be changed only on the basis of a change in the market price of coal. This claim of the operators was sustained by the court below in the Stilwell case. Thereafter, Paragon asked the respondents and Stilwells to sign written agreements which they refused to do because such agreements did not correctly reflect the terms of oral agreements under which they were operating. Paragon took no further action, and from that time until the present has accepted benefits under such agreements without any effort to negotiate the differences or to have them adjudicated. Since Paragon has accepted the coal produced and has made changes in the price per ton only when there were significant changes in the market price of coal, the operators were not aggrieved and have had no occasion to negotiate or adjudicate the alleged differences in the terms of their agreements with Paragon. 6 (R. 56. 154)

⁵ A tax case is not the best forum to decide disputed terms of an oral agreement. The simple, direct and most inexpensive way to determine whether Paragon had the right to terminate at will

SUMMARY OF ARGUMENT

Under the guiding principles of this Court as expressed most recently in *Parsons* v. *Smith*, 359 U. S. 215, and Treasury Department Regulations and Rulings, the coal mine operators are entitled to share with Paragon the depletion allowance for the following reasons:

- 1. The substantial investments made by the operators in the development and operation of their coal mines establishes their capital investment in the coal in place. Said capital investments resulted from the fact that Paragon was unwilling or unable to make such investments in its own behalf and the coal mine operators relieved Paragon of its investment obligations in this respect thereby satisfying the criteria that the taxpayer claiming a share of the depletion allowance must possess a capital investment in the mineral in place.
- 2. The oral leases or contracts were silent on the matter of termination, but because of the substantial investments made by the operators in the coal in place, the operators' rights could not be terminated

would be for it to bring an action of ejectment in Buchanan County where the agreement was made. Or, if, as the Commissioner contends, Paragon could fix the price per ton at will, all it had to do was decrease the price without a corresponding decrease in the market price of coal, then the operators would be in a position to take action. Paragon did neither-it preferred to take the benefits of the agreement as understood by the operators. Paragon is not without resourceful counsel. The terms of the agreements here in question could have been decided long ago and for a fraction of the expense it has spent in connection with this tax litigation if Paragon had so desired. Possibly, Paragon concluded that its chances of success in a local court were not good and it would be better to pursue the costly route of tax litigation. The operators had no similar opportunity to judicially test their right to mine the designated areas to exhaustion. The operators were in possession of the mines and, as far as they were concerned, Paragon was living up to its bargain with them in every respect.

at the will of Paragon without cause, particularly where the parties intended the coal operators to mine as long as coal was obtainable and could be profitably sold.

- 3. The return of the coal mine operators' investments was dependent upon the extraction of the mineral and they shared with Paragon an interest in the proceeds from the sale of coal because they were paid only for marketable coal and the price per ton was subject to change in accordance with changes in the market price of coal.
- 4. The position of the Commissioner, namely, that the operators were being paid for services and that Paragon was legally free to set the price paid to the operators at any level it chose, is speculative in nature, not supported by the record and is contrary to the determination of the court below and to the published position of the Treasury Department in G. C. M. 22730, 1941-1 C.B. 214.
 - 5. The position taken by Paragon that the right to depletion is dependent upon "ownership of the mineral property" is contrary to all decided cases, the Internal Revenue Code and the Regulations thereunder. Paragon's contention that the application of the several factors listed in *Parsons* v. *Smith*, supra, indicates an absence of an economic interest being vested in the operators is in conflict with the facts of this case.

ARGUMENT

It is not difficult to state the general principles which govern the depletion allowance—the problem arises in applying these principles "according to the peculiar conditions in each case" as required by the statute. Respond-

ents' agree with this Court's statement of the controlling principles in Parsons v. Smith, 359 U.S. 215. Respondents further agree with the Commissioner's statements of the applicable general principles of depletion law; namely, that the right to an allocable portion of the depletion allowance depends on the ownership of an economic interest, that there may be more than one depletable interest in the same deposit, that the purpose of the deduction for depletion is in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used in production, and that the deduction is available only to the owner of a capital interest in the mineral deposit. Respondents also agree that the legal form of such a capital interest is unimportant so long as this ownership constitutes a capital asset, a right with regard to the mineral in place.

Respondents submit that the operators had a capital investment in the coal in place and were the owners of an economic interest as the court below found. The Fourth Circuit determined that the claim of the coal mine operators was valid under the rationale of Parsons v. Smith, supra. Thus, it was guided by the legal princi-

ples set forth in that case.

I The Coal Mine Operators Made A Capital Investment In The Coal In Place and Could Look Only To The Extraction and Sale of The Coal Deposit For A Return Of Their Capital

1. Nature and Extent of The Investment Made By The Coal Mine Operators

Each operator made substantial investments in their respective mines during the development stage. The record makes it clear that a designated area was given to an operator by Paragon, after Paragon did some preliminary external facing work (for which the operators paid Paragon) and constructed a road to the general area of the

mine entry. Thereafter, the development of the underground mine was the responsibility of the operator. Unlike a strip mine contractor, who could begin full production immediately upon removal of the overburden with one employee and a mechanical shovel mining hundreds of tons of coal in one day, the drift mine operator could not reach the production stage ⁶ for several months and sometimes years.

It was necessary for the operator to mine underground to a sufficient depth to expose enough coal so that the full compliment of his labor force had individual working areas from which they could mine coal. This required considerable time because the working area was never more than approximately 30 inches high, the only light available was that which the miners could carry on their persons and equipment, the coal had to be loaded by hand and only two or three miners could work in an area at a time. Moreover, if a drift mine is to be practical, the operator must engage, in addition to his own labors, a large number of employees, because each miner can load but a few tons of coal per day. In addition, the first coal mined was not of marketable quality (outcrop coal) and had to be discarded. It normally required six to eight weeks before any marketable coal was reached by the operator and several months before the mine reached the production stage. (R 115, 116, 123, 137, 154, 215)

The coal mine operators, and not Paragon, were obligated under state and federal law, to provide for the

The production stage is defined as that time when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional area for mining, Treasury Reg. § 1.616 - 2(b)

⁷ All of the operators involved in these proceedings are working miners, who devote their full time to their operations and are in their mines every day. In addition to the investment in money they make a substantial investment in time and effort.

safety of the mine, including the development of air courses as well as the main entry. Air courses are necessary for ventilation of the working areas and without them, no drift mine could be operated. The burden of the development of working areas and the establishment and maintenance of air courses was the obligation of the operators. No like capital investment is made by a strip miner. It is quite obvious that these investments enhanced the value of the coal that lay beyond and to the side of the main entry, cross sections, room and air courses, for unless this development was completed such coal could not be mined. These undisputed facts refute the contention that the operators did not have a capital investment in the coal in place.

The operators' investments in the coal in place did not terminate with the end of the development stage. Further capital investments were made during later stages of the mining operation. For example, the mine operator had a continued obligation to maintain roof support of the mine. As the operation progressed, all loose coal had to be removed from the roof and timbers placed on 18 inch centers. Also, pillars of solid coal must be left to help support the roof. Most of the mines in these proceedings extend over a mile underground and in the Stilwell operation, the mine at the time of the hearing (November 1961) was over 8,000 feet long. These pillars are not removed until the operators reach the end of their designated areas. At that time, the operation retreats, the coal forming the pillars is extracted and the mountain settles down closing the area which contained the seam of coal. Proper roof maintenance, the setting of timbers and the facing and preparation of pillars is a capital investment, since without such an investment the coal lying beyond is worthless because it cannot be mined if the roof falls. Each timber and pillar enhances the value of the coal remaining in the ground. Indeed, the pillars are in and of themselves a valuable source of coal which can be mined most economically, but they cannot be mined until they have served their purpose of roof support.

Moreover, the progress of the mining operation does not always result from the extraction of coal. The particular seam of coal here involved, is unpredictable and most difficult to mine. (R. 44, 67). The entries must be driven from time to time through areas where nothing but unmarketable rock is removed. This is due to the irregular nature of the seam of coal, when the coal squeezes out into what is called a "roll". When a roll is encountered, the operator has no choice but to continue mining operations through the rock in the hope that mineable coal will be reached before he goes broke, because the coal beyond the roll cannot be reached unless the roll is overcome. Since cutting machines cannot be used successfully on the rock the procedure is to loosen it by explosives and remove it from the mine. Even though this operation is more costly than mining coal the operators receive nothing for the mining of rock. Many are the drift mine operators, who have broken their financial as well as their physical back on a roll. All of the operators involved here encountered rolls (R. 67, 101, 117, 123)—in one instance an operator mined for six weeks and removed nothing but rock. (R. 123) To consider the operators' excavation of rock anything but a capital investment in the remaining coal is to ignore reality.

By contrast, in a strip mining operation there is no entry, air course, pillars or timbering. If a strip miner encoursers a pinched seam or a roll, he merely moves his equipment further along the surface and begins removing the overburden and the coal where the coal vein resumes. Some distinctions with respect to the capital expenditures of a deep mine and a strip mine were recognized by the Tax Court in National Lead Co., 23 T. C. 988 (1955) rev'd on other grounds 230 F.2d 161 (2 Cir. 1956), aff'd C.A. 352 U. S. 313. In that case, the Tax Court

observed that it was easy to understand that a shaft dug from the surface to a mineral deposit lying under the surface, which shaft is to be used to gain access to the underlying ore and to bring the mined ore to the surface is a capital expenditure made to develop the ore body. The Tax Court added that it was not readily apparent to it that any comparable expenditure was involved in the cost of stripping overburden and cutting benches in an open (strip) mine. In this case the Tax Court's conclusion that the operators' investments were similar to the investments of the contractors in Parsons v. Smith, supra, (R. 222) is most difficult to understand. Possibly it was premised on its obviously erroneous finding that the operators "did not assume any of Paragon's obligations under its leases" (R. 214) As the court below noted "Paragon was under obligation to mine the property. operators were performing Paragon's obligations under its leases . . ." (R. 255). Or possibly it was based on an erroneous understanding of what constitutes an investment or more properly a capital investment.

A capital investment is an expenditure of money or other consideration to acquire something of permanent value for use in carrying on a trade or business—or the consideration paid for a capital asset. Obviously, the removal of outcrop coal, development of working areas, preparation of pillars, timbering, excavation of the air courses and mining through rolls all involved expeditures by the operator that were useful until all the coal was exhausted. After they were made the operators had a capital asset, that is a developed and operating mine, which is useful in their trade or business until the mineral deposit is exhausted.

The development and long term expenditures of the operators are capital in nature, even though they are

^{*} The Stilwells, for example, have been mining in the same mine for thirteen years and the Merritts for over ten.

deductible under Section 616 of the 1954 Code, which provides that expenditures for the development of mines are deductible as an expense in determining income. This provision was part of the Revenue Act of 1951. Prior to its enactment the operators would have been required to carry their development costs in a capital account recoverable through the depletion allowance. Under present law the deduction of development costs is allowable in addition to the depletion allowance. Accordingly, the characterization of such expenditures as capital in nature is in no wise affected by their deductibility.

Under the present statute it makes no difference, therefore, whether these expenditures are made during the production or development stage of the operation. Prior to 1951, however, the difference was important since if the expenditure was made during the development stage, the expense had to be put into a capital account and recovered through the depletion allowance. The cases dealing with tax years prior to 1951, therefore, will show what type of expense had to be capitalized and hence what type of expense represented a capital investment in the mineral deposit, 10 See for example National Lead Co., supra, Clear Fork Coal Co. v. Comm'r, 229 F.2d 638 (6 Cir. 1956) where the court held that development consists of creating enough working places for the use of all available machinery of the mine; Commissioner v. H. E. Harman Coal Corp., 200 F.2d 415 (4 Cir. 1952) where the court held that where machinery was purchased not solely because of the recession of working faces but in the interest of economy and efficiency such expenditures were capital investments; Alsted Coal Co. v. Yoke, 200 F.2d 766 (4

Regulation 94 Art. 23(m-15)(a) All expenditures in excess of net receipts from the mineral sold shall be charged to capital account recoverable through depletion while the mine is in the development stage.

¹⁰ Reg. 118, § 39.23 m - 15(a)(1), Reg. 111, § 29.23 m - 15(a), Reg. 103, § 19.23 m - 15(a).

Cir. 1952) where expenditures by a second coal operator to remove water and debris and to retimber a dormant mine were held to be development costs and chargeable to capital to be recovered through depletion; United States Gypsum Co. v. U. S. 52 AFTR 1819 (D.C.N.D. III. 1957) aff'd 253 F.2d 738 (7 Cir. 1958) where the court held that expenditures for an additional mine entrance, extension of the main haulage track and extension of an air shaft are development expenditures, and Repplier Coal Co. v. Commissioner, 140 F.2d 554 (3 Cir. 1944) cert. denied 323 U.S. 736, where cost of constructing a tunnel even after the development stage was past was found to be of a capital nature. For a comparison of oil well development costs and mine development costs, see Burnet v. Petroleum Exploration, 61 F.2d 273, 276 (4 Cir. 1932), aff'd 288 U.S. 467.

It can be seen from the above that the operators have made substantial capital investments in the coal by their expenditures. The investments involved were not the investments of Paragon, even though some were made to carry out Paragon's obligations under its leases. It matters not that Paragon has not parted with its capital interest other than passing on to the operators the investment risks and obligations that attend development of the mines. A capital interest in the operators can be created by their own investment. In G.C.M. 22730 1941-1 C.B. 214,216 The Commissioner concluded that:

"... [T]he view that a lessor, or sublessor or assignor, parts with no capital interest, though the lessee, or sublessee or assignee acquires a capital interest upon the execution or assignment of a lease, presents no logical difficulties, as the lessee interest, though it may have great potential value, ordinarily becomes valuable only upon investment by the lessee in exploitation or by reason of discovery...

"[at p. 221] The lessee or assignee, like the lessor or assignor who retained a share interest in pro-

duction... but passed on to the lessee the investment obligations and risks that attend development for a share in production, has parted with no capital interest but has merely in turn given another a right to share in production in consideration of an investment made by such other person..."

Since Paragon was financially unprepared and unwilling to assume the investment risks of the development of the mines but passed them on to the operators, neither Paragon, nor the Commissioner is warranted in asserting that the operators did not obtain a capital interest merely because Paragon did not intend to part with its capital interest. The operators' capital investment obviously took place as shown above; their capital interest in the coal was thereby created. The Tax Court's conclusion that the operators paid nothing for the coal and had no legal title to the coal is therefore refuted. Legal title is not determinative and the investments made by the operators in the coal in place clearly vindicates the Fourth Circuit's reversal of the Tax Court.

A mineral in place has often been characterized as a "reservoir of capital investments", G.C.M. 22730, supra. One who furnishes money or is pledged to the development of the property is regarded as making an investment in the mineral in place. Surely, both Paragon and the operators had a share in this reservoir since they pooled their resources, funds and energies leading toward the extraction of the mineral. Neither could recover, process and sell the mineral without the other and the depletion allowance is an attempt to compensate each party for the exhaustion of the mineral. When the area is mined to exhaustion, both Paragon and the operators will be required to look for new areas to mine. In the case of the operators, they will be able to move some of their equipment but most of their investment will lie useless in the vacant mine. If they are to continue in the same business, the operators will be required to reinvest the funds

they recover through the depletion allowance in another mine in the same manner that Paragon will move its tipple and find new sub-leases in another sector. The interests of both Paragon and the operators are being depleted as the coal is mined—both therefore have an economic interest in that coal until it is exhausted.

2. The Operators' Capital Investments Were Made Pursuant to Agreements Which Gave Them A Continuing Right To Mine Their Areas To Exhaustion.

In Parsons v. Smith, supra, the strip miners insisted that they did not wish to be bound by a contract "which would take a long time since if an opportunity opened up [the strip miners] wanted to go back to road building." The strip miners there involved were primarily road builders who were using their road building equipment to temporarily strip mine coal, and they could not be damaged by a short term notice of termination: In a ten day period the strip miners could load all of the coal from which they had removed the overburden. Their investment was in road building equipment and in the relatively fixed cost of removing a known quantity of overburden.

Unlike the taxpayers in *Parsons* v. *Smith*, supra, the operators here would be seriously prejudiced by a termination of their operations. Their investments were long term investments. Their present costs of the construction of an air course for ventilation was made with the understanding that it would be used for all the coal to be mined. Their expense of removing rock during a pinch or roll was made with the thought in mind that there would be removable coal on the other side that they could mine. Their efforts in making pillars, timbering and in draining the mine were made solely with the view of reaching all of the coal in their designated areas.

The fact that the coal mine operators would be required to make long range investments would have been obvious to anyone familiar with drift mining operations and was implicitly recognized at the time the agreements were made. It was known specifically by Clyborne, the controlling stockholder and directing head of Paragon, because the investments which his corporation was obligating the operators to make, were the precise investments which he personally refused to make and which his corporation was unprepared and unwilling to make. (R. 34-36, 253) Indeed it was the policy of Paragon to encourage its operators to make such investments.

Paragon remained silent on the matter of termination at the time the agreements were negotiated for good reasons. If it had reserved a right to terminate, the agreements would not have been made. Respondent Watson stated the position of the operators when he testified "Well, I knew this, we had a certain boundary of coal which was given to us and told we could mine it out. If we had not had that assurance, we certainly would never have invested the sums of money that we did in the property." (R. 173) And, Meadows, not a respondent, testified that Paragon made it clear that Meadows could mine all the coal in his boundary and that if he "had the least bit of idea they could run me off overnight I wouldn't have invested my money there . . .". (R. 183)

The Tax Court correctly found that the right of termination was not specifically discussed at the time the agreements were made. Then, even though respondents and Paragon were before the Tax Court as adverse, but equal parties—both as petitioners having an equal burden of proof—the Tax Court concluded that because the agreements did not contain a specific statement that they were not terminable at will of Paragon or because they did not contain a specific statement that the operator had the right or obligation to mine to exhaustion that as a matter of law the operators did not have such rights. The Tax Court did so in the face of its own finding as to the intent of the parties that: (R. 215)

"It was anticipated by both parties that a contractor [coal mine operator] would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit and as long as the contractor employed proper mining methods and produced coal meeting Paragon's specifications."

The court below properly concluded that this finding as to the intent of the parties negated the Tax Court's conclusions as to the legal rights of the parties under the contract. In reaching its conclusion the Tax Court also ignored the relative position of the contracting parties, the purposes to be accompilshed by the contracts, the nature of the consideration involved on each side and the time and extent of performance by the parties. When these are considered, it is clear that Paragon did not, as a matter of law, reserve a right of termination at will and without cause. The court below stated the principle well when it said: (R. 254)

"It would be inequitable indeed to hold that Paragon might remain silent on this point until the operators had invested their time and money and then take the benefit of the operator's efforts at will and without cause. [citations omitted]"

In a mineral lease where there are no provisions to the contrary, the lessee has the right to terminate at his will, but a corresponding right to terminate is not vested with the lessor, see Summers, Oil & Gas Vol. 2, 2 Ed. § 235, discussed, infra, beginning at page 44, and Donley, The Law of Coal, Oil and Gas In W. Va. & Va., (1951), § 57 p. 70. The reasons for this rule of law are obvious; the long term investments made by the lessee in development of the property should inure to his benefit and to subject that right to termination without cause by the lessor would work an unwarranted hardship. Conversely, no such right is given the lessor for if the lessee terminates, the lessee's investments which have enhanced the value of the mineral property accrue to the benefit of the lessor.

It was the mutual intent and purpose of Paragon and the operators that pursuant to their oral agreements the operators would immediately enter upon the premises, prepare and develop their respective mines and produce coal. This consideration was of value to Paragon, since it relieved Paragon of undertakings which it was obligated to perform under its leases and enhanced the value of such leases. Obviously, the operators could cease operations only if they were willing to lose the investments which they had made in the mineral property. But, even if the operators could cease operations, the agreements are not lacking in mutuality. Phillips Petroleum Co. v. Buster, 241 F.2d 178 (10 Cir. 1957), certiorari denied 355 U.S. 816 involved an oral agreement which was challenged as void for indefiniteness, uncertainty and lack of mutuality. In sustaining the agreement the Tenth Circuit stated at p. 183:

"* * * Harmonizing in full measure with the general principle of law obtaining elsewhere, it is the rule in Oklahoma that the destruction of contracts or agreements for vagueness and uncertainty is disfavored; and that if a contract or agreement is sufficiently definite and certain in its totality that the intention of the contracting parties can be ascertained with reasonable certainty, it is not void for indefiniteness and uncertainty even though it fails to enter into all of the details respecting the subject matter, especially where there has been partial performance.

"Another ground of attack upon the judgments is that the oral agreements lacked mutuality of obligation. The channel of the argument is that there was no agreement in respect to the term or duration of the agreements; that there was no agreement respecting the extent or length of time plaintiffs would irrigate their lands; that there was no agreement concerning the volume of gas plaintiffs would take; that there was no agreement that plaintiffs would not

change to some other type of fuel; that they could take or not take gas at their own whim or caprice: and that in the event they should cease to take gas,. Phillips would be without recourse or remedy. * The oral agreements for the furnishing of gas for the operation of the water wells having been entered into with the mutual intent and purpose that plaintiffs would act in reliance thereon, plaintiffs having acted in such reliance by making substantial expenditures in the drilling or the completing of the drilling of the wells and in preparing the land for irrigation, and plaintiffs being in reasonably certain danger of suffering irreparable injuries for which there would be no adequate remedy at law if the furnishing of gas were discontinued, equity finds support in the law of Oklahoma for intervening and restraining the threatened discontinuance of the furnishing of gas. * * * "

The Tax Court never found as a fact that Paragon had a right of termination; it merely concluded without citing any authority or reasons that "It seems unlikely that the parties would have contemplated granting the contractor [operator] the nonterminable right to mine specific areas to exhaustion without also obligating him to so mine it." (R. 223) Since such an agreement is not lacking in mutuality and Paragon could suffer no detriment, but would benefit from the investment of the operator in the leased property if the operator ceased mining the "unlikeliness" of the Tax Court's conclusion is clearly refuted.

Accordingly, the conclusion of law by the Fourth Circuit as to termination should be sustained. If the Tax Court's finding of fact is correct that nothing was said by either party as to termination, then by implication of law, the right of the operators to mine to exhaustion should be that found by the Fourth Circuit. If the issue is to be decided on past events, then it can be shown that none of the operators here involved or Paragon ever terminated a contract at will. If the issue is to be decided

by what the usual mineral lease contains it must be held that a right to terminate at will is not usually given a lessor. If the issue is to be decided on the finding of the Tax Court as to the intent of the parties, then the operators again must be sustained for the Tax Court specifically found that the parties "anticipated... that a contractor [operator] would continue mining in the location assigned to him as long as the coal could be mined and sold at a profit..." If the issue of termination is to be decided upon what provision the reasonably prudent man familiar with drift mining would include in an agreement, the conclusion that Paragon had no right to terminate at will without cause must again be reached.

Respondents do not understand the Commissioner to contend otherwise. Apparently, it is the Commissioner's position that the operators could be forced out by Paragon exercising an alleged "power" to lower prices.

3. The Operators Could Look Only To The Extraction and Sale of The Coal For A Return of Their Investments

In Parsons v. Smith, supra, the strip miners were to be paid a fixed sum for each ton mined and delivered which was agreed to be in "full compensation for the full performance of all work and for the furnishing of all [labor] and equipment required for the work". On the basis of such an agreement, this Court determined that the strip miners "agreed to look only to the landowners for all sums to become due them under their contracts" and that such an agreement was "a personal covenant and did not grant or purport to grant an interest in the coal in place." In the case at bar the intent, understanding and rights of the parties was quite different.

Paragon was not interested in paying for services, work or the furnishing of equipment required for the work. Paragon was seeking someone to assume its obligations

under its leases to develop and operate drift mines and extract all mineable and marketable coal. Moreover, Paragon made it clear that it was willing to accept and pay only for marketable coal. It would not accept outcrop coal because it was not marketable (R. 54), and Paragon would not pay as much for "solid shot" coal as it would for "machine cut" coal because "solid shot" coal will not bring as much on the market (R. 106). Also, Paragon deducted from the amounts due the operators the weight of any rock and other amounts that were cleaned from the coal at its processing plant. (R. 49) Paragon understood fully that the seam of coal was unpredictable and irregular, that it was a very thin seam "which in some places pinches out entirely". (R. 44) It was fully aware that there would be times when the operators would be working their entire labor force excavating rock and not producing any coal at all. Under the agreements the operators were to receive nothing for such efforts and expenditures.

In Parsons v. Smith, supra, the strip mine operators were guaranteed a fixed price per ton. The mine operators here had no such guarantee—their income (return of their investment) was dependent upon the market price of coal. This was the understanding and it was adhered to by the parties. Whenever there was a significant increase in the market price of coal, the operators expected and received an increase in the price for their coal. And conversely when there was a decrease in the market, they expected and accepted a decrease. Like any business man who is compelled to take less for a marketable commodity, the operators grumbled and complained, but they made no issue of the decreases because they knew that the coal market was depressed. In Paysons v. Smith, supra, the changes in price were made only on the basis of and to reflect increases in labor costs and materials required by the strip miners—the market price of the coal never entered into the agreement in any way. Here, the market price was the controlling factor.

The Tax Court correctly found that it was understood between Paragon and the operators that the price per ton to be paid the operators would vary from time to time and that it did so vary depending upon the market price for the coal over extended periods. (R. 214) It also attributed the variation "to some extent on labor costs" when there was no evidence to support such a conclusion. Some of the increases occurred at a time when the United Mine Workers negotiated increases in their labor contracts. But Paragon was not a union operation and neither were the operators here involved. The particular wage agreements negotiated by the U. M. W. caused a general increase in the market price of coal and this was the basis for Paragon's changing the price paid the operators. Actually, Paragon was not concerned with the labor costs of the operators and knew nothing about such costs.

Stilwell, (R. 114) Lee Merritt, (R. 136) G. W. Merritt, (R. 147) Watson (R. 169, 176) and Meadows (R. 180) testified that under their respective agreements the price per ton would increase or decrease according to changes in the coal market. This testimony was neither contradicted nor challenged by Paragon—indeed it was corroborated by Clyborne. He stated that the "price continued until there was some change in the market substantially, then we would raise or lower it." (R. 56)

Woods testified that the prices which Paragon received for the various sizes of coal on the commercial market changed daily. The operators were producing raw coal or what is referred to as "run of mine" coal. The price for "run of mine" coal does not vary daily with the prices for the various grades of processed coal on the commercial market. Admittedly, the price received by the operators per ton did not vary on a day-to-day basis with the price received on the commercial market by Paragon

for the various grades of coal which it processed and sold. This was not the agreement. It is clear, however, that whenever there was a substantial or significant change in the market price of coal, either up or down, the operators' price per ton was changed accordingly. This was the agreement—the price per ton was not fixed by the terms of the agreement—but was dependent upon the state of the market.

The Tax Court and Paragon place great weight on the fact that changes in price were not made retroactively and, thus, when an operator delivered coal to Paragon he knew the "fixed" price per ton he would receive before he delivered the coal. (R. 222) True, but the price was not fixed and the operator did not know what price he would receive for coal next week, next month or next year. When the agreements were made, the operators intended to recover their investments from the unmined coal over the period it would take to mine their respective areas to exhaustion. Yet because the operators knew on a given day what they would receive for the 100 or so tons mined on that day, it is contended that they were being paid a fixed sum and were thus relying on the personal covenant of Paragon without regard to the market price of coal.

Paragon was the payor, but it refused to give the operators its personal covenant. Under their agreements the operators were required to look beyond Paragon to the market price of coal for the return of their investments. Actually, the price to be paid the operators for the coal they agreed to mine was unknown both to Paragon and the operators at the time the agreements were made. By mutual agreement it was made dependent on factors beyond the control of either party. In this respect this case is distinguishable from Parsons v. Smith, supra.

II. Analysis of the Commissioner's Brief

1. Statement of Facts.

The Commissioner's statement of facts is most incomplete and is not an adequate basis for a determination of this case. In addition, many of the matters stated as fact are inaccurate.

The Commissioner contends that the operators "did not assume any of Paragon's obligations under its leases". (Comm'r Br. 4, footnote 2)

The most burdensome obligation of Paragon under its leases was the obligation to develop the mineral property and remove the coal in the most effectual, workmanlike and proper manner and in conformity with the laws of the State of Virginia and the United States regulating the working of mines, drifts, gangways and other necessar and appropriate openings for airways, and ventilating passageways and to drive the regular size of gangways and airways through such portions of the seams of coal as may prove faulty, or may not yield mineable and merchantable coal and to leave pillars and suppports necessary for the support of all entries and gangways and to mine and recover all coal which by the exercise of care and proper mining methods is practical to recover. IEx. 16-P, Page 4, Paragraphs VII and VIII) Paragon did not have the funds to fulfill these obligations and Clyborne did not want to expose his personal funds to the dangers inherent in meeting these obligations. (R. 35, 45, 55) These are the obligations of Paragon, which the operators assumed. Indeed, they more than assumed Paragon's obligations in this respect. In some of its leases Paragon was obligated to remove only 85% of the mineable and merchantable coal; the operators agreed to extract all mineable and merchantable coal. (R. 211, 254, 255)

The Commissioner refers repeatedly to the agreement of the operators to deliver all coal which they mined to

Paragon; (Comm'r. Br. 5, 7) but he omits the other part of the bargain. Paragon agreed to accept and pay for all marketable coal produced by the operators. (R. 54) It was a mutual obligation in this respect, not a one-sided agreement as the Commissioner supposes. In consideration for the operators delivering all marketable coal produced to Paragon, it agreed to accept all such coal and pay an agreed price which was subject to change on the basis of market conditions.

Next, it is contended that Paragon set and changed at will the price per ton paid the operators. This statement is refuted by the discussion at pages 24 to 27 of this brief. In addition, Clyborne in testimony given in September 1955 (in a case which did not involve the issue of depletion) when asked about the agreements here involved answered as follows: (Ex. 73, p. 13)

"That is right, the price varies from time to time according to market conditions."

The Commissioner's contention is also refuted by the conduct of Paragon. The first change was a negotiated increase which occurred in February 1952. (R. 118, 119) Thereafter Paragon initiated the price changes, but every change occurred at the time when there was a corresponding change in the market price of bituminous coal. Although Paragon had a burden of proof equal to that of respondents, it did not introduce any evidence with reference to the price it received from its exclusive sales agent. John McCall Company for coal sold during this period. It sold its coal in competition with other wholesalers and processors and in the absence of any evidence from Paragon's records (which could have been produced easily by Paragon) it is fair to assume that the changes in Paragon's prices were in accord with changes in the general market for bituminous coal. The record contains a schedule of prices paid the operators (R. 230, Ex. 74) and the Average Price Index of Bituminous Coal for the period here involved as disclosed by the United States Department of Labor. (R. 248-252, Ex. 98) Comparison of these documents show that each increase or decrease in the price per ton paid by Paragon occurred at the time of a corresponding increase or decrease in the market price as shown by the index of the United States Department of Labor. In the Appendix (p. 49) of this brief respondents have prepared a graph based on a comparison of Exhibits 74 and 98. This graph demonstrates the relationship between the price per ton paid the operators and the changes in the market price of bituminous coal.

The Commissioner's claim that the operators' right to payment did not depend upon the existence of sales proceeds is up ealistic. Paragon was engaged in the business of processing and selling coal. The operators would deliver the coal to Paragon's tipple and it would process it, dump it in railroad cars and it was sold to John McCall Company f.o.b. tipple and John McCall Company takes it from there. (R. 107)

It is stated that the operators "were free to quit at any time" (Comm'r Br. 6) If the operators quit, they would not only lose their investment in the mineral property, but would also leave to Paragon's benefit the enhancement of the coal deposit resulting from their expenditures and efforts. G. W. Merritt stated that the matter clearly when he testified, "After I got my investment in there, I couldn't quit" (R. 156) and Watson stated that if they had quit "that development, effort and work and expense would have been lost." (R. 173)

Other erroneous factual statements of the Commissioner have already been discussed and answered in this brief.

2. Argument of the Commissioner

As previously indicated, respondent does not dispute the legal principles stated by the Commissioner, but it is submitted that his application of these principles to this case is unrealistic and unrelated to the facts. It is contended that the operators are required to deliver the coal at whatever price Paragon chose and if they refused to mine at the offered price, Paragon could substitute other operators to do the mining. This statement is pure speculation and is contradicted by the record.

It is true that the operators agreed to deliver all coal to Paragon. But, it is equally true that Paragon agreed to accept and pay for all marketable coal produced by the operators. Thus, both parties had an obligation to each other. The price per ton was set by agreement, but was subject to change on the basis of changes in the market price of coal. The Commissioner contends that Paragon was legally free to set the price at whatever level it chose and could thus force the operators to cease their operations and substitute another operator in their mines. Under the facts of this case neither the law, nor the operators is as helpless as the Commissioner supposes.

Let us assume that at a time when the operators were receiving \$4.25 per ton, there was a significant increase in the price for coal, and Paragon decided to reduce the price to \$4.00, \$3:50 or \$3.00 per ton and the operators refused to deliver coal to Paragon at such a price. Obviously, Paragon could not substitute another operator because the present operators had legal possession of the property. Paragon could bring an action of ejectment and the issue before the court would be whether the parties had abided by the terms of the agreement. If Paragon elected not to bring an action of ejectment, but persisted in its refusal to pay the proper price for the coal, the operators could declare a breach of the agreement and sell the coal to one of the other coal processors in the area. From the proceeds of such sales they could withhold the proper price per ton and remit the balance to Paragon. If Paragon wanted to stop such action, it would be compelled to bring a legal suit in which the issue would

be whether the parties had abided by the terms of the agreement.

In any legal action the position of the operators would not be difficult to sustain. Coal mining is the only industry of any consequence in Buchanan County, Virginia and people there are as knowledgeable as to changes in coal prices, as little-leaguers are to the batting average of Mickey Mantle. (R. 91, 143) The operators couldcompel Paragon to show the price it was receiving for coal at all relevant times and from such data a court could readily determine whether the reduction in price to the operators was in accordance with or contrary to any change in the market price of coal. Moreover, there are standards by which the rights of the operators could be determined. Paragon was purchasing coal from operators on. mineral properties on which it did not hold the lease. On such purchases, it had to pay the market price, otherwise the operator would take his coal to another processor. The price picture of such purchases could be used as a standard to determine whether any change which Paragon initiated was proper under its agreement with its operators. Also, there are other processing companies, some accepting coal from the same seam and in the same area as Paragon. The prices they pay for coal mined by their operators and for off lease coal is common knowledge in Buchanan County. The tipple price being paid by processors in that area is as well known as any other fact of economic life. Such price changes are infrequent, but when they occur everyone knows about it.

To argue, as Commissioner does, that the operators were at the complete mercy of Paragon as to price is not supportable on the record. This depletion controversy with Paragon has extended over the last 8 or 9 years. If Paragon could have controlled this situation by virtue of a legally free right to set the tipple price at any level it chose, and if the operators refused to deliver coal, trans-

fer their mines to another, it would have done so long ago.
(See Footnote 5, supra)

The bargaining power of the operators arose, not from any right that they had to quit, as the Commissioner maintains, but from the right which they had to stay in possession of their mines and compel Paragon to abide by the terms of the agreement.

The improbability of the position he adopts is best illustrated by his comments in footnote 4 (Comm'r. Br. p. 19). Therein, the Commissioner admits that Paragon could not very well exercise the alleged power to lower prices since at a minimum Paragon was required to offer the same tipple price to all the operators. In effect, the Commissioner is saying that Paragon only had the power to terminate none or all of its contracts at the same time; a most improbable and unrealistic proposition, in view of the fact that during its taxable year ending September 30, 1957 on coal produced by its operators, Paragon, after deducting royalties paid to Clyborne of \$154,552.07, reported net income of \$650,981.94, claimed depletion in the amount of \$325,490.97 and paid tax on \$325,490.97. (Ex. 62-BK, Statement of Net Income From Coal Mining and Depletion Schedule)

The court below reached the proper conclusion when it stated "it was understood that the price would, and in fact it did, vary with the market" (R. 254) and that the "operators had a continuing right to produce coal and to be paid therefor at a price which was closely related to the market price." (R. 255)

The other unrealistic and unsupportable position of the Commissioner is that the operators' rights in the mineral deposit were no greater or different than that of the office personnel of Paragon, who likewise may be able to demand higher salaries when business is good. The comparative positions of Paragon's office personnel and the coal mine

operators are not even remotely parallel. An office employee does not make an investment in the coal in place, works at the discretion or will of Paragon, is paid on a time basis, is guaranteed the stipulated amount for his services if he works the required time and works directly under the supervision of Paragon. The office employee offers only his services and Paragon pays him for services and continues employing him as long as such services are satisfactory.

The agreement between Paragon and the operators is quite different. The operators were obligated to make investments in a mineral deposit, Paragon does not tell them when to work or how to work, its interest is only in receiving the coal they produce. The operators are responsible to the governmental authorities for the proper conduct of their mining operations; their only connection with Paragon in this respect is that the operator employ and pay a mining engineer designated by Paragon to assure that they stay within their respective areas, so that their mines do not run together and cause ventilation or safety problems. The operators are not paid for services, have no guaranteed compensation or minimum payment, but are paid solely on the basis of the mineral produced and their income is dependent upon the value of that mineral on the market. The operators employ a large number of laborers and are obliged to meet payrolls and other expenditures over extended periods of time when they are receiving no income whatsoever.

No useful purpose would be served by enumerating the remaining distinctions, nor to comment on the Commissioner's analogy between the operators and an employee in the automobile industry. The facts stated above and elsewhere in this brief demonstrate conclusively that the obligations, rights, and interest of the operators in this case are quite different from those of an employee. Paragon could have offered the operators an employment con-

tract, but it did not want any of the expense, burden and responsibility of development and production of the drift mines.

III Analysis of Brief for Paragon

Respondents will not answer in detail Paragon's labored discussion of the law of depletion. If, as Paragon sometimes states, the depletion allowance is available only to a taxpayer who owns a capital investment or capital interest in the mineral in place, respondents agree and there is no dispute. But, if as Paragon sometimes states, the depletion allowance is available only to the owner of the mineral in place, respondents submit that Paragon's position is contrary to decisions of this Court and to language which has remained in Treasury Department Regulations since 1939 without material change.

If ownership of the mineral in place were essential to the depletion allowance, Treasury Department Regulations would so state, but they provide to the contrary. Section 1.611-1 (b) (1) of the Regulations under the 1954 Code provides that "Annual depletion deductions are allowed only to the owner of an economic interest in mineral deposits or standing timber." If ownership of the mineral were to control it would be simple to so provide by eliminating the words "an economic interest in."

The Regulations adopted as its definition of an "economic interest" the following statement of this Court in Palmer v. Bender, 287 U. S. 551, 557:

"The language of the statute is broad enough to provide, at least, for every case in which the tax-payer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital."

[Emphasis supplied]

The presence of such terms as "at least", "for every case," "any interest" and "any form of legal relationship" in this classic definition forecloses any concept that the depletion allowance is available only to the owner of the mineral deposit. Indeed the holding in Palmer v. Bender, supra, was that depletion did not depend upon any special form of legal interest in the mineral deposits. Recent cases of this Court reiterate this view. Commissioner v. Southwest Exploration Co., 350 U. S. 308; Parsons v. Smith, supra, In the latter case this Court declared at page 221, footnote 7, that the principles of Palmer v. Bender, supra, had been consistently recognized and applied. And near the conclusion of its opinion in Parsons this Court stated at p. 226:

"The controlling fact is that [petitioners] had no interest in the [coal] in place." [P]etitioners simply entered into contracts, terminable without cause on short notice " " to provide the equipment and do the work required to strip mine and deliver coal from those lands, as independent contractors, for fixed unit prices."

Thus, under the regulations and decisions of this Court the essential requirement is not ownership of the mineral in place, but ownership of an economic interest in the coal in place.

Paragon attempts to give an erroneous impression of this Court's holding in Helvering v. Bankline Oil Co., 303 U.S. 362. At pages 27 and 29 of Paragon's brief, Paragon claims that the taxpayer in Bankline had a contract to "extract gasoline" and that "a mere economic advantage" arose "out of a contract to extract that mineral." Chief Justice Hughes clearly set forth the position of this Court on the matter at p. 367:

"It is plain that, apart from its contracts with producers, respondent had no interest in the producing wells or in the wet gas in place It was not en-

gaged in production. Under its contracts with producers, respondent was entitled to delivery of the gas produced at the wells, and to extract gasoline therefrom, and was bound to pay to the producers the stipulated amounts."

The Government's position on Bankline is contrary to the position urged by Paragon. In General Counsel Memorandum 22730, 1941-1 C.B. 214, which contains a discussion of Helvering W. Bankline Oil Company, supra, and Helvering v. Mountain Producers Corp., 303 U.S. 376, with reference to the question of producing and processing the General Counsel states at page 220 that in Bankline:

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ment facilitating delivery of the gas produced rather than in equipment for production of gas, and that its function was not production of gas, but the processing of gas. The Mountain Producers case, supra, is distinguishable in that the refining company purchaser therein was a producer and was required to make the capital investment necessary to production that gave the producer an economic interest in the oil and gas in place." [Emphasis supplied]

The position taken in G.C.M. 22730, supra, underscores the importance of the capital investments made by the operators in the instant case. They were required to make "the capital investment necessary to production". Thereby they obtained an economic interest as in Helvering v. Mountain Producers Corp., supra, and not a mere economic advantage. Paragon uses the word "extract" completely out of context—"extraction of gasoline" from produced gas is not the same as the extraction of ore or gas from a mineral or gas deposit. In the sense that Paragon would employ the word "extraction", the word "processing" is more appropriate.

Beginning at page 58 Paragon asserts that certain legislation supports its position. Its first contention is that

when Congress enacted the words "each separate interest owned by the taxpayer in each mineral deposit" in Sec. 614 (a) I.R.C. 1954, it meant that a taxpayer must own the mineral deposit before it is entitled to depletion. As indicated immediately above this is not the view of the Commissioner as expressed by regulations under the 1954 Code; nor is it the view of this Court which has repeatedly held that the law of depletion requires an economic rather than a legal interest in the mineral deposit. Section 614 deals primarily with unitization and not the allocation of the depletable interests.

Next, Paragon insists that under Section 631(c) of the 1954 Code, the depletion deduction in the case of coal leases belongs indivisibly to the lessee. Section 631(c) provides that in certain situations an owner who disposes of coal under any form or type of contract by virtue of which he retains an economic interest in such coal shall not be entitled to the allowance for percentage depletion, but is entitled to capital gains treatment. In the case of certain owners Congress substituted one form of tax treatment for another. Congress did not, however, change the principle long recognized by the Courts and still a part of our tax law that a number of taxpayers may hold an economic interest in a mineral deposit and share in the depletion allowance, Sections 1.611-1(c)(1) and (2) of the Regulations refer to "several owners of economic interests" and "in the case of a lease or other contract providing for the sharing of economic interest in a mineral deposit, or standing timber." [Emphasis supplied]

In Section 631(c), Congress defined the word "owner" to mean "any person who owns an economic interest in the coal in place including a sublessor." Yet, Paragon insists repeatedly the ownership for purposes of depletion means ownership of the mineral deposit in place.

The Treasury Department has not by regulation, nor has the Government in litigation, placed such an interpretation on these sections—even though the statute has been in existence for twelve years. Paragon does not cite any Committee Reports, Treasury Department Rulings or decided cases in support of its interpretation.

Beginning at page 70 of its brief, Paragon discusses the several factors enumerated in Parsons v. Smith, supra, indicative of the absence of an economic interest, and Paragon attempts to apply those factors to the instant case. Its assertions are refuted by an examination of the facts:

- 1. Paragon states that the operators investments were in their equipment, all of which was movable—not in the coal in place. This assertion is fully answered at pages 11 to 19 of this brief.
- 2. Paragon contends that the operators' investments in equipment were recoverable through depreciation—not depletion. The operators had some equipment on which they claimed depreciation, but the major portion of their investment was in the coal in place as indicated under 1 above. It should be noted that every dollar that Paragon has expended in this enterprise has been deducted for tax purposes as a business expense or through depreciation or authorization. (R. 84) Thus, Paragon has no investment whatsoever that it is not recovering in some manner other than through depletion.
- 3. It is asserted that the contracts were completely terminable without cause on short notice. Such assertion is answered at pages 19 to 24 of this brief and comment here will be limited to the points raised by Paragon.

First, Paragon contends that Paragon could not give an absolute monterminable right to mine to exhaustion in view of the landowners reserved rights under the Paragon lease to terminate in the event of noncompliance with the terms of the lease. Most leases are terminable in case of default and if Paragon could terminate only at the penalty of losing its entire interest in the mineral deposit it could hardly be regarded as an agreement in which Paragon has an absolute right to cancel at any time without cause or condition.

In Commissioner v. Southwest Exploration Company, supra, Southwest held the right to drill for oil, but it was provided that if Southwest should default in the performance or observance of any of the terms, covenants and stipulations, its right to drill and produce oil could be cancelled. (p. 315) Thus, by default Southwest could terminate the rights of the upland owners, but this was not deemed significant and the upland owners were allowed depletion. As noted in that case the "tax law deals in economic realities, not legal abstractions".

Next Paragon argues that this case should be decided on the basis of a clause in an inconsistent sentence, quoted out of context, from two exhibits. Exhibits 86 and 87. (R. 231-246) were offered by Paragon and received by the Tax Court for impeachment purposes only. (R. 161) Now, after the trial is concluded, Paragon, having disavowed any such purpose at the trial, insists that these exhibits are independently probative as admissions. These exhibits were prepared by C. J. Stull. G. W. Merritt testified that Earl Bowman brought the documents to Grundy one night, asked Merritt to sign them-which he did-and that Merritt took them downstairs and had them notarized. Merritt never met Stull and did not know where he got his information. Merritt denied reading the documents and stated that he never made such statements to anyone and they were not correct. (R. 156-161) Merritt did not swear that he read these documents; nor did he sign on the page containing the verification. A notary, public signed the verification, but whether she read it or asked Merritt, about it is not known. The information which Stull used was obtained from Bowman from some undisclosed source. Bowman is a former employee of R. C. Persinger & Company, accountants for the respondents. At the time of trial Bowman was working for the accountant who does the accounting work for Paragon. (Tax Court Transcript 1227-30)

If Exhibits 86 and 87 are to be used to impeach Merritt or if they are independently probative as admissions the entire document should be examined.

Both exhibits contain in the Statement of Facts section the following:

1. "The partnership was obliged to extract all mineable coal in the area allocated to it". [Emphasis supplied]

The above statement is hardly consistent with a right to

2. "The question of the right to terminate never arose between the partnership and Paragon." [Emphasis supplied]

If the question never arose, how could the contract have specified the right of termination by either party. Later in the Argument section of each protest it is stated:

"The contract specified the right of termination by either party at any time, but the question never arose between the partnership and Paragon."

As indicated, if the question never arose, how could the agreement specify the right of termination. The sentence is inherently inconsistence. If Merritt's testimony is to be impeached it should be done with clear and consistent statements and not by a document which in the main corroborates his testimony, but which contains one inconsistent sentence.

Each document contains the statement that the agreement was similar to the agreement considered by the court below in Stilwell v. United States, 250 F.2d 736 (4 Cir. 1957). As Paragon concedes the court below determined in the Stilwell case that the agreement was not terminable. (Paragon Br. 74) A fair examination of the provisions, including the inconsistent sentence relied on by Paragon, leads to the conclusions they were the same as the Stilwells, that is, not terminable as the court below decided.

Having insisted that Merritt changed his testimony, Paragon seeks to explain it by arguing that terminability did not assume any importance in decisional law until the decision in United States v. Stallard, 273 F.2d 847 (4 Cir. 1959). According to Paragon, Merritt was not concerned about terminability until sometime after December 1959 when he became aware of the headnote in the Stallard case and decided to swear up to it at the trial of this case. To make this theory of Merritt's shortcomings plausible, Paragon must ignore, as it does, the headnote and controlling finding of the court below in Stilwell v. United States, supra, decided December 27, 1957, approximately five months before Exhibits 86 and 87 were signed. The headnote in Stifwell mentions in an important way the fact that the contract was not terminable at will. In addition, the court below in discussing the crucial factors in Stilwell states "A most important factor is the terminability of the taxpayers' rights."

It is open to question whether Merritt read the Stallard headnote or not. There can be no doubt, however, that Merritt had an avid interest in the opinion in the Stilwell case for the understandable reason that his agreement was also with Paragon and contained the identical terms and conditions. Also, his mines were adjacent to Stilwell's and he was in almost daily contact with the Stilwell brothers. If Merritt is a self-serving falsifier as Paragon contends, the occasion for him to serve himself by false statements was in May 1958 when he hoped to set-

the his case by showing it was the same as Stilwell. That he signed documents at that time with an inconsistent statement as to termination indicates an attitude of reliance on those whom he had engaged to handle his tax matters. Such an attitude is not uncommon in Buchanan County, Virginia—particularly among coal mine operators who are not educated in matters of law, accounting of tax procedure. It might be added that it is not uncommon for taxpayers to sign documents without reading them. Unless Merritt read page 8 of these Exhibits he would not have known that he should have read them before signing.

Paragon makes no comment on the testimony of its General Manager Woods. Although he did not make the agreements here involved, Woods testified that if an operator mined properly and produced coal and complied with state and federal regulations he had the right to stay and mine the coal. (R. 106)

Paragon contends that many operators quit at will. None of the operators involved in the present litigation ever terminated his agreement, although some did purchase mines, mining rights and equipment from other operators thereby working a novation and not a termination. (Exhibit 84) Other operators did quit, but the reasons for their doing so are not a matter of record. Many drift mine operators go broke and are compelled by financial circumstances to abandon their operations and leave their investments, but whether this is a termination at will is open to question. A contract terminable at will is one in which there is an absolute right to cancel at any time without cause or condition. It is clear that the operators could terminate only on the condition that they leave their investments in their mines.

The position of Paragon that as "a matter of state law it is plain that if a contract is at the will of one party, it is at the will of both" is not well taken. Cowan

v. Radford Iron Co., 83 Va. 547, 3 S. E. 120 (1887) is a judicial mutation and the point for which it is cited by Paragon was dictum, which has been thoroughly disapproved in later cases in other states and has not been followed in Virginia: Summers, Oil and Gas, 2 ed Vol. 2 Section 235 "Leases as a Tenancy at Will" presents a full discussion of the erroneous doctrine in Cowan and its subsequent rejection by the Courts. Summers concludes that following the lead of the Ohio court in Brown v. Fowler, 65 Ohio St. 507, 63 N. E. 76 (1902) the federal and state courts, except for some early decisions in Oklahoma and Texas, had rejected the erroneous doctrine that an oil and gas lease created a tenancy at will."

The other cases cited by Paragon are also inapposite. The rule which it states applies only to an agreement which is wholly executory and consists of mutual promises each the consideration for the other. It does not apply where consideration has been given for a mineral lease, which gives the lessee an interest in the right to explore and develope the mineral property and the mineral produced, even though he has the privilege of surrendering the lease at any time. Lindlay v. Raydire, 239 F.928 (D.C.E.D. Ky 1917) affirmed 249 F. 675 (6 Cir. 1918). The Lindlay case discusses Cowan v. Radford, supra, and notes that it is of no value upon such a question even in the jurisdiction of Virginia.

What Paragon ignores is the partial and continuing performance of the operators. Whether either party could have terminated before the operators began performing under their agreements of the rights of Paragon in the event of abandonment by an operator is not the question, but whether Paragon, after having encouraged and obligated the operators to act to their detriment, could take

¹¹ Under Virginia law, the principles applicable to oil wells are also applicable to mines, Graham v. Smith, 196 S.E. 600 (S.C. App. Va. 1938)

the benefits of the operators' investments at will and without cause.

- 4. Paragon argues that as lessee it did not agree to surrender and did not actually surrender any capital interest in the coal in place. This contention is answered fully elsewhere in this brief. It is noted here that Paragon agreed to and did surrender to the operators an interest in the coal in place, its right to mine the coal, or to determine who would mine it. Before entering into agreements with the operators Paragon did not own the coal in place, but held the right to mine the coal and reduce it to possession and ownership. After these agreements it held the right to acquire and sell it only. The operators held the right to mine the coal, reduce it to possession and be paid in accordance with the market.
 - 5. Paragon insists that the coal belonged entirely to it at all times. It has been herein shown that ownership of the mineral is not essential to the depletion allowance. The mineral belonged to the landowners until it was extracted and reduced to possession by the operators—then Paragon could acquire it if it so elected, under its agreement with the operators to handle all marketable coal. If it was marketable, Paragon accepted the coal and immediately after delivery sold it to John McCall Coal Company. If the operators produced coal which was not marketable Paragon would not take it. Before and after the coal was mined it did not belong entirely to either Paragon or the operators. The latter had certain rights in the coal at all times.
 - 6 and 7. Paragon's contentions that the contractors were to be paid a fixed sum for each ton and that payment was dependent upon the personal covenant of Paragon without regard to the market price of coal have already been answered, supra, at pages 24 to 27.

8. The "rigid control of the actual mining operation" argument of Paragon is not supported by the record. It is contended that the engineer directed the operators in de-The engineer was selected by Paragon, but was paid by the operators, whom he served with reference to all engineering work inside the mines. (R. 60). The engineer inspected the operations generally when called by the operators and rendered his services when needed at their request. (R. 116) On the few occasions when disputes arose it was the operators and not the engineer who resolved the differences. Actually, the function of the engineer was to assure that the various mines stayed within their areas. Aside from this rather tenuous argument, Paragon cites no other facts which would indicate any control over the mining operation. Paragon fails to mention the vast number and variety of independent actions taken by the operators over which Paragon had no control. It was interested only in receiving the production from the operators' mines and indicated little interest and had no control over the way such mines were operated. It was the operators and not Paragon who were directly responsible to the federal and state coal mine authorities for the safe and proper conduct of their mining operations. In short, all decisions regarding the mining of coal were made by the operators and not Paragon. (R. 53, 54, 118, 129, 254)

IV Comments of Amicus Curiae Brief of Jewell Ridge Coal Corporation

In an amicus curiae brief filed in No. 134 Jewell Ridge Coal Corporation seeks to influence the deliberation of this Court by suggesting that if the present case is affirmed the Commissioner's petition in No. 262 should be granted to consider additional arguments allegedly available in that case. Such argument according to Jewell Ridge is that: (Jewell Ridge Br. 2, 3)

tween Jewell Ridge and its contract mine operators that Jewell Ridge could, as it did, maintain complete unilateral control over the amount of coal which its contract mine operators were from time to time permitted to mine."

This statement is simply not true. The terms of the agreements between Jewell Ridge and its mine operators have been considered by the Tax Court on two occasions in recent years. Norman E. Clifton Tax Court Docket No. 64659 decided April 21, 1958, Par. 58,065 P-H Memo T.C., and Raymond E. Cooper, et al, 39 T. C. 253 (1962). The court made no such finding in either case—indeed the contrary is true. In Norman E. Clifton, supra, the Tax Court found as follows:

"8. Jewell Ridge agreed to accept all coal produced by petitioner [contract mine operator] and there was no limitation on the amount of coal petitioner could produce."

The arguments of Jewell Ridge are the same as those made by the Commissioner and Paragon and respondents will not burden this brief with a repetitive discussion thereof.

CONCLUSION

On the basis of this Court's decision in Parsons v. Smith, supra, the court below concluded that the operators owned an economic interest in the mineral in place. This determination was based on the obligations of Paragon under its leases, which were assumed and performed by the operators, the continuing rights of the operators in the mineral deposit and the right to be paid for coal produced at a price closely related to the market price of coal: In these vital respects this case is clearly distinguishable from Parsons v. Smith, supra—indeed principles

of that case require an affirmance of the decisions of the court below.

Paragon placed the burden of development and production upon the operators, it agreed to pay only for marketable coal and it was the understanding between the parties that the income of the operators would be dependent upon the market price of coal. Under these circumstances, the depletion allowance is to be shared by the operators and Paragon because they were jointly interested in the development, production, processing and sale of the coal to be extracted. The decisions of the court below should be affirmed.

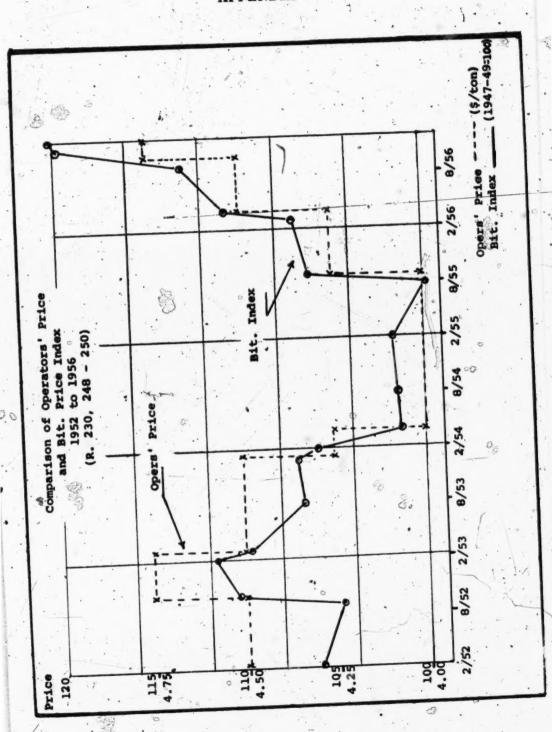
Respectfully submitted,

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Counsel for the Respondents in No. 237

February, 1965

APPENDIX



No. 134

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Washington, D. C. 20006

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 134

PARAGON JEWEL COAL COMPANY, INC., Petitioner

COMMISSIONER OF INTERNAL REVENUE

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF AS AMICUS CURIAE OF JEWELL RIDGE.

As amicus curiae, Jewell Ridge confines this reply to answering arguments of respondent Robert Lee Merritt' in opposition to points made in Jewell Ridge's opening brief.

¹ References herein to "Merritt" are to respondents Robert Lee Merritt et al. in No. 237, which is consolidated with No. 134. References to "R. Br." are to the brief for respondents in No. 237, and references to "J.R. Br." are to Jewell Ridge's opening brief as amicus curiae.

1. LEGAL CONTROL OF THE COAL DEPOSIT REMAINED IN PARAGON

The coal mine operators concede, as they must, that before entering into the oral contracts here in question Paragon, as lessee of the coal deposit, held the sole right to reduce the coal to possession and ownership (R. Br. 45). The operators also concede that under the contracts they were required to deliver all coal they mined to Paragon (R. Br. 28-29, 31). Nevertheless, the operators contend that, once the oral agreements were made, they, not Paragon, held legal control of the coal deposit. This is made plain by respondents' statement that (R. Br. 45):

"Before entering into agreements with the operators Paragon... held the right to mine the coal and reduce it to possession and ownership. After these agreements it held the right to acquire and sell it only. The operators held the right to mine the coal, reduce it to possession and be paid in accordance with the market."

Whether the operators acquired legal control of the coal deposit is critical, since if they did not their claim to a depletion deduction must fall (J.R. Br. 13, 16-17, 27).

At one point respondents state that under the oral contracts Paragon could acquire the coal "if it so elected" (R. Br. 45). But elsewhere they concede that coal properly refused by Paragon could not be taken elsewhere by the operators (R. Br. 25, 28-29, 31). In the final analysis, the operators' position that they had legal control of the coal deposit is founded upon an alleged oral agreement by Paragon that it would accept and pay for all marketable coal produced by the operators (R. Br. 29, 31). To support this position

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the operators cite (R. Br. 29) a portion of Clyborne's testimony to the effect that, to the best of his knowledge, Paragon had always taken all the marketable coal which the operators mined (R. 54).

It is true that during the years here involved Paragon did take all the marketable coal produced by the contractors operating on Paragon's leased property (R. 216). But that does not necessarily indicate that there was an agreement or unflerstanding that Paragon would take all such coal. It is equally consistent to infer that the contract mine operators produced no more coal than Paragon desired from time to time. Further, this is the logical inference since, as is said in the operator's brief, they could not produce and sell coal without Paragon (R. Br. 18). This was true because the raw coal the operators mined was not salable on the market, but had to be washed, graded and treated to be salable (R. 216), and Paragon alone had the right to apply the ordinary treatment processes necessary to obtain the marketable product.2 Hence the reasonable inference is that, needing Paragon's

The operators' statements in their brief that (if Paragon refused to accept and pay for the coal they mined) it would have been possible for them to sell the raw coal to other coal companies in the area (R. Br. 31) and that there is a "price" for such coal (R. Br. 26, 32) are unsupported in the record and open to question. Jewell Ridge will not accept such "bootleg" coal, and it understands that other coal companies in the area will not do so, since it could not be known whether the lease royalties and United Mine Workers benefits had been paid in respect of such coal (so that the company accepting such coal might become liable to the United Mine Workers Welfare Fund as well as to the lessor or the lessee. or both). In the present case Paragon's contract mine operators undertook no obligation to pay lease royalties (R. 214) and contend that they had no obligation for payments to the United Mine Workers Welfare Fund (R. Br. 26). Hence it is doubtful that they could have sold the coal elsewhere.

treatment (and sales) facilities to process (and sell) the coal, the operators would gear their mining operations to Paragon's desires for raw coal. Moreover, a witness for Paragon testified that when Paragon's coal treatment plant was closed, sometimes for as long as a week, the operators could fill their mine cars and bins, but then were required to shut down until Paragon was ready to take more coal (R. 99; cf. R. 130). And the Tax Court found this to be the fact (R. 216). All these recited facts of record are inconsistent with respondents' assertion that Paragon agreed to accept and pay for all marketable coal produced by the operators (R. Br. 29, 31). Instead such facts, taken together with the admitted facts that Paragon was the sole lessee of the coal lands and the operators were required to deliver all coal to Paragon, confirm that under the oral contracts legal control of the coal deposit remained in Paragon (J.R. Br. 15-16). This factor, even if it stood alone, is sufficient to defeat the operators' claim (J.R. Br. 16-17).

2. THE CONTRACTOR HAD NO FIXED OR DETERMINABLE RIGHT TO SHARE IN THE VALUE OF THE COAL

Even were it true (as it is not) that Paragon was bound to accept all marketable coal the operators produced, Paragon was not obligated to pay a fixed or determinable price for the coal. Most, perhaps all, of the evidence of record in this respect is cited and reviewed in Jewell Ridge's brief (pp. 19-21). Nevertheless, referring to a few isolated portions of the record (R. Br. 26) and relying heavily on a graph allegedly showing a direct relationship between the amount Paragon paid operators and the Bituminous Coal Index (R. Br. 29-30, 49), the operators repeatedly assert that whenever there was a substantial or signifi-

cant change in the market price of coal, either up or down, the operators expected and received a corresponding increase or decrease (R. Br. 25, 27, 30), that this was the agreement to which the parties adhered (R. Br. 25, 26, 27, 31, 32), that the market price was the controlling factor (R. Br. 26) and that the operators were required to look beyond Paragon to the market price of coal for the return of their investments (R. Br. 27).

The issue on this point is, therefore, clear. The operators contend that there was a direct and legally enforceable contractual linkage between the value of the coal extracted and the amount to which they were entitled. The Tax Court found to the contrary (R. 222). And this finding was not contradicted by the Court of Appeals (see R. 254, lines 13-15 and R. 255, lines 27-29). Moreover, the operators' contention is refuted, not only by the evidence of record recited in Jewell Ridge's opening brief (pp. 19-20), but also by the very comparison of Exhibits 74 and 98 on which respondents so heavily rely, as will now be shown.

First, in February 1952 there was a 12.5% increase, from \$4.00 to \$4.50 per ton, in the amount paid operators (R. 230), even though the market price of bituminous coal had remained steady as a rock (varying only one or two percentage points from month to month and but fractions of a point from year to year) since December 1949 (R. 250-251). Respondents attempt to explain away the February 1952 change in the operators' compensation as a "negotiated increase" (R. Br. 29) and they omit it from their graph (R. Br. 49). But respondents' witness explained the change as an increase requested by the contractors and granted by Paragon to cover the contractors' costs of opera-

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tions (R. 119). Hence the first change was inconsistent with the alleged agreement that "the market price was the controlling factor" (R. Br. 26).

Second, the market price of bituminous coal dropped 3% in April 1952 (equal to a 131/2 cents decrease in the operators' then \$4.50 piecework rate). This coal price drop, the first one so large in two years, continued through May and June into July and August and was not entirely erased until October, 1952 (R. 250). Nevertheless, the operators' \$4.50 piecework rate was not decreased, but remained constant throughout this entire period (R. 230). Like the February 1952 piecework rate increase, respondents omit the April 1952 coal price drop from their graph (R. Br. 49), perhaps on the ground that it was not "significant". But it seems clear that they would have thought significant a 131/2 cents decrease in their rate of compensation (R. 142, 169). Hence the second change was inconsistent with the alleged agreement that "the operators were required to look beyond Paragon to the market price of coal for the return of their investments" (R. Br. 27).

Third, the record indicates that the operators were notified at least two or three days in advance of any increases or decreases in their rate of compensation (R. 87, 93, 105). In any event, no later than October 1, 1952, Paragon increased the operators' rate to \$4.75 (R. 230). Respondents' witness testified that this increase was due to a rise in the costs of labor (R. 119). And this seems likely, since the increase preceded, and did not follow, the price rise which occurred in October 1952 (R. 250) after the costs of labor had gone up in the coal fields (R. 119). Moreover, the October 1, 1952 increase in the operators' rate occurred either

before or just as coal prices recovered from the aforementioned April 1952 price drop (R. 250). Hence it seems unlikely that the increase could have been thought of as compelled by a coal price rise. All these facts tend to confirm the testimony of respondents' witness that the October 1, 1952 increase in the operators' rate, like the February 1952 increase, was made to cover the operators' costs. Hence it is clear that the third change, like the two (discussed above) which preceded it, was inconsisent with the operators' present contention that their compensation "was dependent upon the market price of coal" (R. Br. 25).

Enough has been said above to show that the asserted oral agreement, allegedly linking the operators' rate to the market price of coal, simply did not exist. But at the risk of belaboring the point, since respondents so strenuously and persistently insist to the contrary and their case depends on it, perhaps a few additional inconsistencies between the evidence of record and the alleged oral agreement should be noticed.

From October 1952 through March 1953, the bituminous coal index gradually climbed from about 110 to about 112 in January and then subsided to about 110 again in March (R. 249, 250), without any increase in the operators' rate (R. 230). Nevertheless, no later than March 1, 1953 (R. 230) and probably a week or so before then (R. 87, 93, 105) and at least a full month before the April 1953 drop in the market price of coal (R. 249), Paragon cut the operators back to \$4.50 per ton (R. 230). Respondents' witness attempted to explain this decrease as: "they told us that the price of coal went down and they would be forced to cut the price in order to run" (R. 119). But the operators also say that they "are as knowledgeable as to changes

in coal prices, as little leaguers are to the batting average of Mickey Mantle" (R. Br. 32). If so, they knew that the market price of coal hand gone down. And if there were such an agreement as they now alleged, they not only would have objected strenuously (R. 142, 169) but, according to their brief, they would have taken legal action (R. Br. 9, fn. 5). They did neither (R. 119, 142). Like any operators "compelled to take less", they "grumbled and complained, but they made no issue of the decreases" (R. Br. 25). For "as far as they were concerned, Paragon was living up to its bargain with them in every respect" (R. Br. 9, fn. 5).

The foregoing recitations from the record show that the March 1, 1953 decrease in the operators' rate, like all the other changes which preceded it, cannot with logic or consistence be reconciled to the operators' present allegation that their rate of compensation was contractually linked to the market price of coal. Instead these facts of record, like others cited and reviewed in Jewell Ridge's opening brief (p. 20) confirm the Tax Court's conclusion that the operators "had no knowledge or interest in the price that Paragon received from the sale of the coal" (R. 222).

Near the beginning of January, 1954 (R. 230), after the price of coal had been stable for nine months (R. 249), and at least two months before the March, 1954 drop in bituminous coal prices (R. 249), Paragon again cut the operators' rate, this time to \$4.25 (R. 230). Just like the March 1, 1953 change, discussed immediately above, the January 1954 change was fatally inconsistent with the operators' present alleged view of the oral contract and fully consistent with Jewell Ridge's view (J.R. Br. 19-21).

Near the end of March, 1954, when the Bituminous Coal Index fell to 102.5, the lowest point in nearly six years (R. 249-251), Paragon further reduced the operators' rate to \$4.00, the same rate they were paid in 1951 and early 1952 (R. 230). But in April, 1955, when the Bituminous Coal Index plummeted to near 98, and remained near there through May, June, July and August (R. 249), Paragon did not decrease the amount paid its operators (R. 230). Rather, at the end of August, 1955, in which month the Bituminous Coal Index hovered at 99.7 (R. 249), Paragon increased the operators' rate to \$4.25 (R. 230). The April 1955 drop in the coal market (like the April 1952 drop mentioned above), is not reflected on respondents' graph (R. Br. 49). The reasons for these omissions are not explained in respondents' brief.

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Respondents' say that there was no evidence that any of the changes made by Paragon in the operators' rate reflected changes in the operators' labor costs (R. Br. 26). But respondents' own witness, G. W. Merritt, testified that: "most of the time, when the union would get an increase, why we generally got an increase there" (R. 147).

The cumulative effect of the facts of record recited herein demonstrate that respondents' position will not bear close analysis. (A) The February 1952 and October 1, 1952 increases in the operators' rate to cover their costs, without at the time there having been any substantial coal price rise, (B) the April 1952 and April 1955 failures of Paragon to cut the operators' rate despite sharp, substantial and prolonged coal price drops, (C) the March 1, 1953 and January 5, 1954 cuts of the operators' rate during periods of good coal prices and substantially in advance of any coal price

drop, and (D) the increase in the operators' rate at the end of August, 1955, when coal prices were at their lowest ebb, all these combine with the facts of record cited and summarized in Jewell Ridge's opening brief (pp. 19-20) to support and confirm the Tax Court's uncontradicted conclusion (R. 222) that there was no direct or indirect contractual or other legal linkage between the value of the coal which the operators extracted and the amount of compensation to which they were entitled. This then is a second essential test the operators have failed to meet (J.R. Br. 21-23).

S. EVEN IF ALL THE CONTRACTORS' CONTENTIONS WERE CORRECT. THE INTERESTS THEY CLADRED WERE NOT DEPLETABLE

Apparently respondents would prefer to forget that, even if all their contentions were correct, an operator's income did not depend solely on the coal he extracted from the deposit in which he claimed an interest. Nevertheless, the point is important. And respondents have not answered it.

The source of an operator's income, insofar as it actually came from coal, was all the coal mined from Paragon's leasehold, and not the coal mined by the operator. For this reason also, the interests claimed were not depletable (J.R. Br. 24-26).

³ Since amounts due contractors were payable by Paragon whether it gained or lost on sale of the coal (R. 128, 214), such amounts were payable from Paragon's borrowed or equity capital (R. 216), so that coal proceeds was not the sole source of an operator's income, despite respondents' statement to the contrary (R. Br. 30).

4 INTEREST OF AMICUS CURIAE

In respect of No. 262, respondents assert that a statement by Jewell Ridge (as to an understanding that it could, as it did, control the amount of coal its operators were from time to time permitted to mine) was "simply not true" (R. Br. 47). In support of this assertion, respondents try to rely (R. Br. 47) on the Tax Court's decision in Norman E. Clifton, T.C. Memo. 1958-65, CCH Dec. 22, 936 (M), for the proposition that: "Jewell Ridge agreed to accept all coal produced by petitioner [contract mine operator] and there was no limitation on the amount of coal petitioner could produce." The reliance is misplaced.

than Commissioner v. Raymond E. Cooper, et al., No. 262, this Term. In considering the record in Cooper, the Tax Court was well aware of its earlier findings and opinion in Clifton. Yet with all the testimony and exhibits of the earlier case and two additional volumes of testimony in the later case both directly before it, and though expressly requested to do so by respondents, the Tax Court in Cooper refused and omitted to make the very finding upon which respondents now attempt to rely.

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In the Cooper case, all the testimony on this point (of contract mine operators Cooper, Smith, Clifton, Harris, Sheets and McFall and of Jewell Ridge's employees Bunton, Youell and McBurney) was to the

On motion by respondents Raymond E. Cooper, et al., the testimony and exhibits in the Clifton case were received in evidence in the Cooper case.

same effect. The questions asked by the Government's counsel and Bunton's answers will suffice as a sample:

"Q. During 1953 . . . through July, 1958, did Jewell Ridge exercise any control over production of these truck mines?

A. Yes, sir.

Q. How did they do it?

A. By whether or not they operated the tipple.

Q. What would they do? A. We would just close the tipple down and put out the sign there was no work. And when we got ready to go back to work we would post another sign a work sign. Those were posted in the pay roll offices at the Jewell Ridge Coal Corporation" (Tr. 229).

Hence it is true that in No. 262, despite respondents' statement to the contrary (R. Br. 47), there was an express understanding between Jewell Ridge and its contract mine operators that Jewell Ridge could, as it did, maintain complete, unilateral control over the amount of coal which its contract mine operators were from time to time permitted to mine. For this and other reasons mentioned in Jewell Ridge's opening, brief, if the present case is reversed No. 262 should be also, whereas if the present case is affirmed the Commission's petition in No. 262 should be granted.

Transcript references in the Cooper case are pp. 73-74, 96, 119-120, 154-155, 177, 201, 229, 270-271, 303-304, all of which were cited to the Court of Appeals in the Commissioner's brief, p. 19.

Within a few miles of each other in the same area of Virginia, Jewell Ridge operated three coal treatment plants, termed "tipples", one of which was used primarily to prepare coal mined by Jewell Ridge's contract mine operators.

CONCLUSION

For the reasons stated herein and more fully developed in Jewell Ridge's opening brief, the judgment of the Court of Appeals, permitting depletion deductions to the contract mine operators, should be reversed and remanded for entry of an order affirming the Tax Court.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM 1964

No. 237

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

V.

ROBERT LEE MERRITT, ET UX., ET AL.

On Writ of Certiorari To the United States Court of Appeals for the Fourth Circuit

BRIEF OF RAYMOND E. COOPER ET UX., ET AL. AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

Raymond E. Cooper, et al, with written consent of all parties to the case, which consents are on file with the Clerk, respectfully presents this brief on the merits in support of respondents.

INTEREST OF AMICUS CURIAE

The position of amicus curiae, Raymond E. Cooper, et al, is similar to that of respondents (No. 237). This

References are to the appellants in Commissioner v. Raymond E. Cooper, et al, 330 F.(2d) 163 (4 Cir. 1964), in which the Com-

position is challenged by Jewell Ridge Coal Corporation as amicus curiae, not only in a brief filed on the merits in No. 134, but also in a reply brief filed in No. 134 which is in substance a reply to the brief for respondents in No. 237. This brief will be limited to a discussion of the "reply brief" filed by Jewell Ridge as amicus curiae in No. 134.

ANALYSIS OF REPLY BRIEF AS AMICUS CURIAE OF JEWELL RIDGE COAL CORPORATION

Jewell Ridge maintains (Reply Brief, pp. 2, 3) respondents in Number 237 have failed to support by adequate citations to the record that Paragon had the duty and obligation to accept and pay for all marketable coal produced and mined by the operators. At page 5 of respondents' brief in the Statement of Facts referring to Paragon's obligation to so accept all coal, the following pertinent references were noted:

R. 54, 64, 114, 136, 147, 180, and 186.

In addition thereto the record contains evidence of this obligation of Paragon's at the following references:

R. 50, 94, 105, 113, 131 and 142

Accordingly, Paragon's obligation is clearly established by the record, contrary to Jewell Ridge's contention.

Next, Jewell Ridge misquotes respondents by stating that the operators could not produce and sell coal without Paragon. (Reply Br. p. 3). The statement made by respondents was that under the agreements "neither [Paragon or the operators] could recover, process and sell the mineral without the other." (Rep. Br. p. 18)

missioner's petition for writ of certiorari (No. 262) was not granted pending a decision in the present case.

Jewell Ridge contends that other coal companies in the area would not buy "bootleg" coal, if the operators attempted to sell their coal to processors other than Paragon. (Reply Br. p. 3, Footnote 2) The Commissioner employed speculative reasoning in his brief by advancing as his main contention that Paragon could set the price paid the operators at any level it chose and if they failed to produce coal replace them with other operators. Respondents countered by showing that if Paragon committed such a breach of its agreements, they would be legally free to sell the coal elsewhere and remit to Paragon its share of the selling price. Now Jewell Ridge, which is but one of a number of coal processors in the area, asserts that it would not buy such coal. It must be clear however, that the coal would not be "bootleg" coal since the operators would be exercising their right and duty to mitigate damages in view of a breach of contract by Paragon. Moreover, neither Paragon nor the operators is unionized, so there is no problem of liability to the United Mine Workers Welfare Fund on such coal.

The reference to the fact that Paragon on occasion shut down its tipple for repairs, shortage of railroad cars and other business reasons (Reply Br. p. 4) and the operators would also suspend operations underscores the mutuality of the agreements and the fact that they were both interested in the successful and profitable selling of the coal produced. The suspensions were always of a short duration, for good reasons and the operators always had repairs, water drainage, roof support, rock removal and maintenance work which they could do while they were waiting on Paragon.

G.C.M. 26290 1950-1 C.B. 42 was the position of the Commissioner at the time the agreements between Paragon and the operators were made. This ruling of the Treasury Department still represents the announced position of the Government on strip mining and it has been

cited with approval by the courts, Parsons v. Smith, 255 F. (2d) 595, 598 (3 Cir. 1958), aff'd. 359 U.S. 215 and Usibelli v. Commissioner, 229 F. (2d) 539, 543 (9 Cir. 1959). In G.C.M. 26290, supra, the Treasury Department adopted the following position:

"In the opinion of this office, a contract which is terminable by the coal company at will, and which thus fails to vest in the contractor the requisite capital interest in the mineral in place, is one in which the coal company has an absolute right to cancel at any time without cause or condition.

"One of the contracts examined shows that the coal company reserves the right, without payment of damages, to 'suspend' work indefinitely at any time or from time to time; under another contract, the coal company is given the right, upon 5 days' notice to the contractor and without payment of damages, to 'suspend' work for an indefinite period; and under a third contract the coal company may 'suspend' operations during such time or times as the company operates at a loss because of the minimum payable to the contractor. Since contracts of this character, despite the power of indefinite suspension provided for therein, do not, except under specific conditions, appear to permit the coal company to dismiss contractors absolutely and substitute others to extract the mineral, it is the opinion of this office that such contracts should not be classified as contracts which may be cancelled. 'at will'."

The attempt of Jewell Ridge to minimize the correlation between the amounts paid the operators (R. 230, Ex. 74) and the Bituminous Coal Index (R. 247-251, Ex. 98) is not well founded. (Reply Br. pp. 4 to 10). It insists (p. 9) that in August 1955 when the Bituminous Coal Index hovered at 99.7, Paragon increased the operators rate to \$4.25. Not so, Paragon did not increase the operators' rate to \$4.25 until September 1, 1955 (R. 230) when the index went up to 106.3 (R. 249). Other state-

ments of Jewell Ridge in this regard are equally inaccurate.

The graph (Respondents' Brief p. 49) shows the general relationship of the bituminous coal market to the price the operators received and it is apparent that the correlative factor is extremely high. The relationship of the operators' price to the price Paragon received for processed coal, or the price it paid for off lease coal would be more meaningful. But Paragon did not introduce its price data into evidence, even though its burden of proof was equal to that of respondents and even after respondents had introduced the Bituminus Coal Price Index. The rule governing such situations is well stated by the Tax Court in Wichita Terminal Elevator Co., 6 T.C. 1158, 1165, aff'd 162 F. (2d) 513 (10 Cir. 1947):

"The rule is well established that the failure of a party to introduce evidence within his possession and which, if true, would be favorable to him, gives rise to the presumption that if produced it would be unfavorable... This is especially true where, as here, the party failing to produce the evidence has the burden of proof or the other party to the proceeding has established a prima facie case."

Jewell Ridge insists that the amounts due the operators were payable by Paragon whether it gained or lost on sale of the coal and such amounts were payable from Paragon's borrowed or equity capital. (Reply Br. p. 10, Footnote 3) Such a view ignores both the legal and economic realities of the agreements here involved. The operation was a continuing venture and not a series of unrelated sales by the parties. When the coal market declined significantly Paragon had the protection of a corresponding decrease in the price paid to the operators. The operators were not so fortunate... they either could not or did not decrease the wages of their employees. (R. 120) Moreover, Paragon's borrowed and equity capi-

tal did not suffer. Paragon's last taxable year before the Court is the year ended September 30, 1957. Its tax return for that year (Exhibit 62-BK, Schedule L) shows that after five years of operations it had earned surplus and undivided profits (after payment of dividends) of \$1,207,140.05, cash in the amount of \$534,369.35 and notes receivable of \$428,972.59.

Again, Jewell Ridge seeks to influence the deliberations 'of this Court by making statements of alleged facts from the record of Commissioner v. Raymond E. Cooper, et al, No. 262 this Term. (Reply Br. pp. 11, 12) The propriety of such tactics is open to question, but as long as Jewell Ridge pursues such a course, it should be accurate in its statements. The testimony cited by Jewell Ridge from another case merely emphasizes the fact that in Buchanan County, Virginia processing coal companies are not able to run continuously due to breakdowns, lack of railroad cars or a temporary lack of coal orders. When this occurs, the coal mine operators cooperate and also suspend their production. (See G.C.M. 26290 and discussion at pages 3 to 4, supra) On the question of the alleged control of Jewell Ridge over the production of its operators, other testimony of its Secretary and Treasurer Bunton is more in point. When asked about an attempt on the part of Jewell Ridge to terminate the operations of some of its operators Bunion testified as follows: (Transcript of Testimony Cooper Case p. 244)

[&]quot;Q When the miners refused to—these six refused to be terminated, you continued to accept their coal, did you not?

A Yes, sir."

CONCLUSION

For the reasons stated herein and more fully developed in the Brief for Respondents filed herein, the judgment of the Court of Appeals permitting depletion deductions to coal mine operators should be affirmed.

Respectfully submitted,

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MARCH, 1965